

## **Appendix I (1) – Issue Papers: Pricing Policies, and Price Post and Hold**

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Appendix I (1)  
\* \* \* Issue Paper Developed to Inform the Task Force \* \* \*  
Policy Assessments, Impact Assessments and Potential Options were drafted to spark  
discussion and were not necessarily adopted or confirmed by the Task Force  
**Pricing Policies, and Price Post and Hold**

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## EXECUTIVE SUMMARY

The state has used a number of direct and indirect pricing regulations to prevent the misuse of alcohol and to monitor the flow of alcohol. These regulations are designed, in part, to increase the cost of the product, based on the assumption that price influences consumption (higher prices discourage consumption) and lower consumption, in general, limits the misuse of alcohol.

**The LCB also enforces several regulations designed to “level the playing field” by ensuring that all retailers (large and small) receive the same price for the same product.**

The regulations related to “Price Posting and Hold” were the most frequently cited as problematic to industry representatives in interviews and were rated as a high priority for potential change by the Task Force. Price posting and hold requires that suppliers and distributors post their prices for each specific beer and wine product by a specific date, and hold them for a calendar month after the posted price is effective.

- **The LCB believes this practice is key to controlling the importation and distribution of beer and wine, and an effective tool to monitor other pricing regulations** such as the ban on quantity discounts and uniform pricing requirements.
- **Many industry stakeholders believe the “post and hold” regulations are burdensome and complicated with no benefits to them and no direct benefit to controlling the misuse of alcohol.**

The state’s post and hold requirements are among the regulations at issue in the Costco lawsuit, and the district court decision invalidated the current regulations as an unlawful restraint of trade. This decision is on appeal.

### **Potential Options for Price Posting and Hold:**

1. No change (no impacts, but may need to change if the court decision holds.)
2. Eliminate Price Posting, and shorten the Hold requirements

**Potential benefits:** Reduces the burden on businesses to post and reduces the time required to hold prices providing more flexibility, still provides some price stability.

**Potential drawbacks:** Eliminates an efficient state enforcement tool and may require more state resources to audit compliance.

3. Eliminate Price Posting and Hold

**Potential benefits:** Reduces the burden on businesses and provides more market flexibility

**Potential drawbacks:** Eliminates an efficient state enforcement tool and may require more state resources for audit compliance.

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#### State Beer and Wine “Pricing” Policies, Generally

The state employs a variety of strategies to control the sale and distribution of alcohol in Washington State in order to achieve the state’s policy goals:

- ✓ Prevent the misuse of alcohol,
- ✓ Promote the efficient collection of taxes, and
- ✓ To promote the public interest in fostering the orderly and responsible distribution of malt beverages and wine towards effective control of consumption.

Two strategies<sup>1</sup> the state uses to prevent the misuse of alcohol are:

- **Prevent access to *cheap* beer / wine by maintaining various pricing-related regulations** designed to increase the price of beer and wine and to prevent alcohol from being used as a loss leader by retail licensees who sell to consumers.
- Providing industry participants a “level playing field” that **assures a particular product is sold at the same price to all retailers from the distributor / producer**. According to the LCB, without a level playing field, there is greater incentive for the retailer with higher costs to go outside the system to buy the product cheaper.

The general purpose and desired effect of the state’s pricing policies is to assure that beer / wine is reasonably available to consumers at reasonable prices, while making it more difficult to sell them at prices so low as to encourage excessive or abusive consumption.

Some industry representatives interviewed expressed concerns that many of the regulations unnecessarily distort the market. Those who raised a concern with the regulations generally agreed that the state should liberalize their regulations to provide a more “free market” approach to alcohol distribution and sale.<sup>2</sup> A few suggested that other methods of ensuring a higher price to the consumer (such as increasing the state tax rate on alcohol beverages) could possibly achieve the same outcome, without imposing unnecessary burdens on business.

**See Appendix A for a more in-depth discussion of the background and history of LCB’s pricing policies and post and hold requirements.**

## I. SUPPORTING THE STATE’S POLICY GOAL OF REDUCING MISUSE OF ALCOHOL

### A. By Maintaining Higher Prices:

In addition to maintaining strict separation among the tiers, the regulatory structure in place today was designed to impose constraints on free market competition. These regulations include:

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<sup>1</sup> The state uses a wide array of strategies to prevent the misuse of alcohol that are not discussed here, such as enforcing minimum drinking age laws, restrictions on hours and location of sale, etc.

<sup>2</sup> Stakeholders preferring a more free market approach included manufacturers, retailers and independent distributors. The Washington Beer and Wine Wholesalers Association and the prevention and treatment community participants did not necessarily support a more free market approach.

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- ✓ Requirements that beer and wine manufacturers and distributors “post” the prices they charge for their products and “hold” those prices for one month (often referred to jointly as the “post and hold” requirements);
- ✓ Prohibitions on providing discounts for high quantity purchases;
- ✓ Requirements that manufacturers and distributors mark up their prices by a minimum of 10%;
- ✓ Requirements that retailers pay upon delivery of beer and wine;
- ✓ Retailers cannot receive credit from the distributor or supplier;
- ✓ Requirements that beer and wine be delivered directly to the retailer’s outlet, or delivered to the retailer at the distributor’s outlet, with the delivered prices the same for both.

These regulations act as a system, constraining beer and wine-related businesses in the three tiers and presumably serve to keep prices higher than they would be in a completely “free market” system.<sup>3</sup>

**The LCB believes this regulatory system supports the state’s policy goals of preventing misuse of alcohol by maintaining higher prices.** Many manufacturers, and retailers, and some wholesalers interviewed for this project said these regulations are unnecessarily burdensome on their business, and did indeed increase their cost of doing business.

#### **B. By Maintaining a Level Playing Field:**

Some of the regulations are designed to “level the playing field” which in turn helps maintain higher prices. These regulations include:

- ✓ Prohibiting quantity discounts, and
- ✓ Requiring that all distributors receive the same price from a manufacturer, and all retailers receive the same price from the distributor for a particular product.

These regulations are intended to ensure that small entities have the same opportunity in the market place as the large entities.

**The LCB believes retailers who can purchase beer and wine at lower cost through quantity discounts, will almost certainly pass their cost savings along to consumers in the form of lower retail prices.**

## **II. RESEARCH SHOWS A RELATIONSHIP BETWEEN PRICE AND CONSUMPTION**

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<sup>3</sup> According to the LCB, each of these regulations also has other purposes besides simply raising business costs and thus keeping consumer prices high. For example, the “post and hold” requirements act as an enforcement mechanism, supporting the LCB’s requirements of uniform pricing among other things; and the prohibition against distributors offering credit to retailers supports the separation of the tiers and lessens the opportunity for retailers to become overextended (and thus be tempted to make illegal sales to turn a profit more readily.) These are discussed in greater detail in the sections that follow.

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**Current research studies generally show that increases in alcohol beverage prices are seen to reduce both alcohol sales and problems.** Most studies of alcohol consumption and alcohol-related problems, however, fail to estimate all of the links in the chain of causality running from the *policy tool* to *price* to *alcohol consumption patterns* to *public health outcomes*. This makes it difficult to quantify the relationship between the cost to Washington's wine and beer related businesses of complying with the current regulatory system and its impact on abusive use of alcohol.

See Appendix B for a more detailed discussion of the current research on the relationship between alcohol policy, price and consumption.

The following section addresses one of the highest priority issues/potential change items in this category.

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#### PRICE POSTING AND PRICE HOLD REQUIREMENTS<sup>4</sup>

**Reference** for current law/rule/practice: RCW 66.28.180(2); 66.28.180(3); WAC 314-24-190; 314-20-100

#### I. BRIEF ISSUE STATEMENT AND CORRESPONDING QUESTIONS

*Price Posting and Price Hold requirements are considered by many licensees to be burdensome, complicated, and of limited value to business and the state. Others believe these requirements provide transparency in pricing; they are part of a larger system that serve to maintain higher beer and wine prices; and therefore serve to reduce abusive consumption and they assist the LCB to monitor and enforce compliance with other regulations.*

- 1. Should Washington's requirement that manufacturers and distributors post their prices be retained, modified or eliminated?*
- 2. Should Washington's requirement that manufacturers and distributors hold their prices for one month be retained, modified or eliminated?*

#### II. DESCRIPTION OF THE EXISTING REGULATIONS

**What are the Price Posting and Price Hold (commonly referred to as “post and hold”) requirements?**

RCW 66.28.180 requires that each month suppliers post the prices of beer and wine sold to distributors, and that distributors post the prices of beer and wine they sell.

- Beer and wine suppliers must post their prices by the 25<sup>th</sup> day of the month, and that price will become effective on the first day of the second month following filing.

*Example: Winery A posts their prices to the LCB on the 25<sup>th</sup> of January. Those prices go into effect on March 1, and cannot change during March.*

- Beer and wine distributors must post their prices by the 10<sup>th</sup> day of the month, and that price becomes effective on the first day of the following month.

*Example: Distributor B posts their prices to the LCB on the 10<sup>th</sup> of January. Those prices go into effect on February 1, and cannot change during February.*

	NUMBER OF PRICE POSTINGS SUBMITTED IN FY 2005	
	ANNUAL TOTAL	MONTHLY AVERAGE
Suppliers	474,225	39,519
Distributors	1,761,591	146,799

*Source: LCB Staff, July 7, 2006*

Prices are posted by the business entity to a Web site administered by the LCB, and the LCB maintains the electronic system. All prices become effective at the same time (the first day of the month), and all prices must be held constant for the entire month. Prices are posted for each package type. Each licensee is given a password, allowing them to access the system to post or view prices of all products in the system. Licensees cannot view competitors' postings until the prices become effective.

<sup>4</sup> The state's post and hold requirements are among the regulations at issue in the Costco lawsuit, and were invalidated by the federal district court judge's ruling. This decision is on appeal in the 9<sup>th</sup> Circuit Court of Appeals.

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### III. PERSPECTIVES ON THE PRICE POSTING AND PRICE HOLD REQUIREMENTS

#### A. Benefits

- Price posting provides an efficient mechanism for LCB enforcement staff to track all products sold in this state. The posting creates an audit trail that LCB Manufacturers, Importers and Wholesale (MIW) enforcement officers can use to investigate alleged violations.
- The system also provides transparency of prices, since the information is accessible by the industry and the public.
- The system provides a way for investigative staff to check whether suppliers and distributors are adhering to the 10% markup, and capture information on when the 10% markup has been violated.
- The post and hold requirements, together, make it more difficult for businesses to undercut each other's prices. Everyone is required to hold their prices for a one-month period. This prevents (or greatly reduces the potential for) price wars that could result in lower beer / wine prices.
- MIW staff use data from the Price Posting system: as part of their periodic spot checks; when prompted by a complaint from the public about a pricing violation; and as baseline information for determining whether a retailer is selling product below cost.
- The "post" component of the system allows the LCB to readily observe the prices that distributors are charging retailers for beer and wine, enabling them to easily determine whether or not a supplier or distributor is complying with the quantity discount ban and mark up requirement.
- The "hold" component of the system prohibits distributors from changing prices frequently, is intended to ensure all retailers pay the same prices for beer and wine during the "hold" period.
- The LCB believes the presence of this tool encourages compliance and that its absence would lead to more non-conforming behavior.

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#### B. Drawbacks

During focus group interviews, many (but not all) industry representatives raised the following concerns about the price posting and price hold requirements.

- Price posting is time-consuming and restrictive. The system and the regulations make it difficult to change mistakes and penalties for inadvertent violations (i.e. errors in data entry) are overly harsh.
- The post-and-hold rules make it difficult or impossible to take advantage of market conditions; they are too inflexible. Businesses are required to post too far ahead of time.
- Price posting is anticompetitive, antiquated and restricts business in being able to respond to market opportunities. It can take 60 to 90 days to respond to potential opportunities or to fix errors.
- Price posting keeps quality products out of Washington because suppliers and importers do not want to go through the hassle of doing business here.
- Businesses should be allowed to negotiate their prices with their customers like any other industry.
- Information available in the system is not generally used by industry to monitor competition.

#### C. What Other States Are Doing: Price Posting around the Country

Several states have eliminated their prior price posting requirements, including California (for wine only), Oregon, Delaware, and Nebraska. Oregon's price posting system was eliminated in the late 1980s as a result of a court decision. According to an Oregon Liquor Control Commission representative, there have been no pricing related complaints in the four years that she has been at the Commission. Today, the Nebraska LCB audits impacted businesses every three years. They have conducted no official study of the effect of its elimination, but no significant enforcement issues have emerged.

Several states do continue to have price posting requirements in place. In Maryland, for example, a business can post once and leave it in place indefinitely until the price changes. Minnesota requires importers to post their prices, but wholesaler price posting was eliminated 15 years ago. Kansas has price posting but no hold requirements. **Appendix C provides a more detailed discussion of other states' price posting requirements.**

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#### IV. CONTRIBUTION TO THE STATE'S POLICY GOALS

1. Do these regulations contribute to the state's policy goal of preventing the misuse of alcohol? If yes, how?

Yes.

- ✓ Aids enforcement of quantity discount ban, minimum mark up requirements, no sale below cost, and prohibitions on price changes for the specified period of time.
- ✓ Results in higher and more stable prices for beer and wine. The higher costs of beer and wine to retailers will result in higher retail prices to consumers. Higher prices are believed to reduce consumption and misuse.

2. Do these regulations contribute to the state's policy goal of efficient collection of taxes? If yes, how?

Yes.

- ✓ Provides an audit trail to verify the accuracy of taxes owed and collected.

3. Do these regulations promote the public interest in fostering the orderly and responsible distribution of malt beverages and wine towards effective control of consumption? If yes, how?

Yes.

- ✓ According to the LCB, the price posting and hold requirements act as a deterrent to businesses attempting to evade the regulations all distributors and manufacturers must follow.
- ✓ The hold provisions contribute to price stability and reduce the opportunity for price wars.

#### V. CURRENT SYSTEM IMPACT ASSESSMENT

*NOTE: This impact assessment is offered to stimulate productive discussion and is based on feedback received from industry participants, a brief review of relevant materials and research literature. It is not intended to provide an exhaustive assessment of all potential impacts. The impacts identified have not been thoroughly tested or evaluated.*

CONSUMER	BUSINESS	STATE	SOCIETY
Higher prices	Burdensome, inflexible, lost market opportunities	Aids enforcement efforts	Possible reduction in abusive consumption

A more detailed discussion of current system impacts is provided in Appendix D.

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## VI. POLICY OPTIONS FOR CONSIDERATION

*NOTE: These options are offered to stimulate discussion. **They are not necessarily the best or only alternatives available.** The analysis of potential benefits and drawbacks represents our best efforts at assessing impacts based on feedback received from industry members, and a brief review of relevant literature. They have not been thoroughly tested or evaluated.*

	Consumers	Business	State	Society
Option 1	NC	NC	NC	NC
Option 2	+	+	--	--
Option 3	+	+	+	--

### OPTION 1: No change

Potential benefits: Gives the state additional time to consider an alternative mechanism for pursuing the state's policy goals, while awaiting results of the appeal of the Costco case.

Potential drawbacks: The district court decision ruled that the price posting and hold requirements are an unlawful restraint of trade and therefore unenforceable. Unless a higher court overturns this ruling, the statute cannot stand.

### OPTION 2: Eliminate Price Posting, and shorten the Hold requirements

Potential benefits: This option reduces the administrative burden on businesses, and gives flexibility to respond to changing market conditions and to take advantage of emerging opportunities. The reduced cost to business of compliance may reduce the impact on prices.

Potential drawbacks: Enforcement of the reduced hold requirement would be difficult, and eliminating the price posting would make it easier for businesses to disregard other pricing related regulations (such as the ban on quantity discounts, the minimum mandatory mark up). If prices decline as business costs are reduced, the incidence of alcohol abuse may increase.

### OPTION 3: Eliminate Post and Hold requirements

Potential benefits: Businesses would be free to take advantage of new market opportunities, Businesses could respond more quickly to competitors' price changes, administrative burden of compliance would be eliminated. Customers could benefit, therefore, from reduced beer and wine prices.

Potential drawbacks: The state's enforcement resources and administrative costs would increase. This would also increase the burden and costs of enforcement of other price-related controls (quantity discounts, etc.) If prices are indeed reduced, there may be some impact on the level of alcohol consumption and abuse, if no counter measures (such as education and social norming) are pursued.

## **APPENDICES**

- A: Background and History of LCB's Pricing Policies and Post and Hold Requirements**
- B: Relationship Between Alcohol Policy, Price and Consumption**
- C: Price Posting Requirements in Other States**
- D: Current System Impact Assessment**

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#### APPENDIX A: Background and History the state's Pricing Policies and Post and Hold Requirements

##### The State's Role in Alcohol Regulation

With the repeal of national prohibition in 1933, the regulation of beverage alcohol reverted from the federal government to individual states. At that time, 27 states elected to restore the sale of alcohol beverages by licensing private parties, four (4) states elected to remain “dry”, and 17 (now 18) adopted state control mechanisms, in which the state exercised direct control over the wholesale and, in most cases, retail distribution of alcohol beverages. The “control states” (as they have come to be known) believed that through government intervention in the marketplace, the state could implement policies that would enable adult consumers who wished to consume alcohol beverages access to such products, while encouraging consumption in a socially responsible manner. The state could control, for example, the hours of public availability for sale, the number of sale locations, and price structure. In addition, the state's role would reduce the scope for private sector profit motive that may lead to increased sales of alcohol beverages.

Washington is a control state. Today the state retains control over the purchase, warehousing, distribution and retail sales of all “spirits.”<sup>5</sup> Beer and wine are distributed and sold primarily through the “three tier” system comprised of private manufacturers, wholesalers, and retailers that are licensed and regulated through the LCB. The state has in place a comprehensive regulatory system that is designed to strictly separate the retail tier from both the manufacturing and wholesale tiers. (The state's three-tier system will be the focus of a later discussion and therefore is not addressed in depth here.)

##### Background and purpose of the “Post and Hold” statute

Price posting has been required in Washington State since 1935, shortly after the state's distribution and control system was put in place. At that time the rule applied only to brewers and beer wholesalers, and the requirement was extended to in-state wineries in 1939.

Changes to the rules and eventually the laws related to price posting have been continuous over the years. Most of the changes to the post and hold regulations have been minor (such as allowing freight differentials to different areas within the state.) Other changes have been more significant, such as the addition of price posting for out-of-state wineries in 1969, incorporation of the price posting intent and rules into state law in 1995, and the advent of electronic price posting in 1997.

The intent section added to the post and hold regulations in 1995, when the rule was codified in state law, states:

*Intent. This section is enacted, pursuant to the authority of this state under the twenty-first amendment to the United States Constitution, to promote the public's interest in fostering the orderly and responsible distribution of malt beverages and wine towards effective control of consumption; to promote the fair and efficient three-tier system of distribution of such beverages; and to confirm existing board rules as the clear expression of state policy to regulate the manner of selling and pricing of wine and malt beverages by licensed suppliers and distributors. RCW 66.28.160(1)*

According to the LCB, the price posting system is a key part of the state's regulatory scheme controlling the importation and distribution of all beer and wine products sold in this state. The system provides an efficient mechanism for LCB enforcement staff to track all products sold in this state. The posting

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<sup>5</sup> "Spirits" means any beverage that contains alcohol obtained by distillation, except for flavored malt beverages, but including wines exceeding twenty-four percent of alcohol by volume. RCW 66.04.010(36)

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creates an audit trail that LCB Manufacturers, Importers and Wholesale (MIW) enforcement officers can use to investigate alleged violations, such as:

- An allegation that a distributor sold at a price different than the posted price (e.g., offered a quantity discount); or
- An allegation that retailers were charged different prices for the same product by the same distributor/supplier.

The system also provides transparency of prices, since the information is accessible by the industry and the public. (Although only licensees can access the system from remote locations, the LCB does provide a viewing space and computers to members of the public.) Further the system provides a way for investigative staff to check whether suppliers and distributors are adhering to the 10% markup, and capture information on when the 10% markup has been violated.

According to LCB staff, the post and hold requirements make the bans on quantity discounts, credit sales, and uniform pricing easier to enforce and more difficult to evade. The post and hold requirements, together, make it more difficult for businesses to undercut each other's prices. Everyone is required to hold their prices for a one-month period. This prevents (or greatly reduces the potential for) price wars that could result in lower beer / wine prices. Although staff and industry members can make use of the system, most of the individuals in our focus group interviews reported they did not use the system for that purpose and the same information can be readily gathered by other means. MIW staff use data from the Price Posting system: as part of their periodic spot checks; when prompted by a complaint from the public about a pricing violation; and as baseline information for determining whether a retailer is selling product below cost.

The "post" component of the system allows the LCB to readily observe the prices that distributors are charging retailers for beer and wine, enabling them to easily determine whether or not a supplier or distributor is complying with the quantity discount ban and mark up requirement. In addition, the "hold" component of the system prohibits distributors from changing prices frequently, ensuring all retailers pay the same prices for beer and wine during the "hold" period.

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#### APPENDIX B: Relationship Between Alcohol Policy, Price and Consumption

A substantial amount of research has been conducted to examine the relationship between alcohol beverage pricing and consumption.

- In general, these **studies show that alcohol consumption falls when prices rise.**
- Since there is some concern about using alcohol “consumption” as a proxy for alcohol “abuse,” recent studies have examined the relationship between alcohol prices and various measures of alcohol abuse, including liver cirrhosis death rates and motor vehicle fatality rates.<sup>6</sup> **These studies also support the theory that increases in alcohol beverage prices reduce both alcohol sales and alcohol-related problems.**<sup>7</sup>

However, as is so often the case, the devil is in the details. Most econometric studies of alcohol consumption and alcohol-related problems fail to estimate all of the links in the chain of causality running from the *policy tool* to *price* to *alcohol consumption patterns* to *public health outcomes*. It is difficult to quantify the relationship between the cost to Washington’s wine and beer related businesses of complying with the LCB’s regulatory system and its impact on abusive use of alcohol. A few of the limitations in the current research are noted below:

**Alcohol is a complex product that lends itself to substitutability.** In general economic theory, a widget is a widget is a widget. Alcohol products, however, vary significantly in quality, type, purchase location (bar versus a grocery store, for example), purpose for drinking, etc.. A consumer may be willing to pay significantly more for a high-end wine than, say, a fortified wine. Taste, packaging, product image, all play a role in a consumer’s decision on how much she is willing to pay. So a consumer may be willing to make tradeoffs if prices rise, rather than not purchasing alcohol at all. Instead of drinking in a high-end bar, one may chose to buy a bottle of wine from an off-premise retailer and take it home. Or, one may substitute a less-costly brand, or switch from wine to beer.

**What is the “right” price?** Another problem with putting into practice this theory of maintaining higher prices to reduce consumption is that little research is available that focuses on determining what *is* the “right” price. If prices are raised too high, consumers will stop purchasing from the legitimate marketing system, and turn to illegal, but less expensive venues. If prices are too low, consumers may be prompted to drink too much, and problems could escalate. Some researchers suggest that the price of product should reflect the costs to society associated with the product (cost of prevention and treatment of alcoholism, DUIs, automobile accidents, lost wages, illnesses associated with long-term abuse of alcohol such as cirrhosis of the liver). Washington is a step ahead in this area because we have relatively sound data about the cost to the state of alcohol abuse.<sup>8</sup>

**It is difficult to quantify a particular regulation’s effect on price.** Even if the state could make sound determinations about what prices would adequately reflect the societal costs of misuse, we have little evidence about how much added costs these particular regulatory constraints produce. In addition, there is little evidence about how much added costs these regulatory constraints add to business costs.

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<sup>6</sup> *Are Alcohol Tax Hikes Fully Passed Through to Prices? Evidence from Alaska.* Kenkel, Donald, Draft paper prepared for AEA session on “Alcohol Taxation and Construction,” Philadelphia, Pennsylvania, January 7, 2005.

<sup>7</sup> *Alcohol Prices, Beverage quality, and the Demand for Alcohol: Quality Substitutions and Price Elasticities.* Gruenewald, Paul J. et al. *Alcoholism Clinical and Experimental Research*, Vol. 30, No. 1, 2006, pp. 96-105

<sup>8</sup> *The Economic Costs of Drug and Alcohol Abuse in Washington State, 1996.* Wickizer, Thomas, DASA, 1996.

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#### APPENDIX C: Price Posting Requirements in Other States

Several states have eliminated their prior price posting requirements California, Oregon, Nebraska, Delaware. Minnesota requires importers to post their prices, but wholesaler price posting was eliminated 15 years ago. Nebraska LCB reports that its price posting regulations were struck down by the Nebraska Supreme Court in the 1980s. Today, the Nebraska LCB audits impacted businesses every three years. They have conducted no official study of the effect of its elimination, but no significant enforcement issues have emerged.

California's retail price posting system was struck down because it required wholesalers and retailers to enter into resale price maintenance agreements that were themselves per se antitrust violations.<sup>9</sup> Similarly, Oregon's price posting law was also invalidated in the 9<sup>th</sup> circuit's *Miller v. Hedlund*, 813 F.2d 1344 (9th Cir. 1987).

Several states do continue to have price posting requirements in place. In Maryland, for example, a business can post once and leave it in place indefinitely until the price changes. Kansas has price posting but no hold requirements.

The following analysis of Price Posting in Twelve License States was conducted by Connecticut's Office of Legislative Research, February 14, 2000.

#### SUMMARY

Twelve of the 38 license states, or almost one-third, require wholesalers to post alcoholic beverage prices to retailers. These are: Connecticut, Delaware, Georgia, Indiana, Maryland, Massachusetts, Missouri, New Jersey, New York, Oklahoma, South Dakota, and West Virginia.

Five states-Connecticut, Delaware, Missouri, New Jersey, and New York-require wholesalers to post their prices monthly. In six states, they must be filed by the fifteenth day of the month preceding the month prices take effect. Post-off provisions (a price reduction not tied to the quantity of alcohol purchased by retailers) are permitted in Delaware, Missouri, New Jersey, New York, and West Virginia. The following nine states allow wholesalers to change prices at various times in the month preceding the month changes are to occur: Connecticut, Delaware, Georgia, Indiana, Missouri, New York, Oklahoma, South Dakota, and West Virginia. Five states-Connecticut, Delaware, Massachusetts, Oklahoma, and West Virginia-require price dissemination by either direct mail or publication in an applicable trade journal.

Table 1 (attached) provides a breakdown of applicable alcoholic beverage price-posting laws in the twelve states requiring such procedures.

#### PRICE-POSTING

Five states-Connecticut, Delaware, Missouri, New Jersey, and New York-require wholesalers to post their prices monthly. Three-Georgia, Indiana, and South Dakota-require them to continuously update price-posting schedules as changes occur. Wholesalers in Massachusetts and Oklahoma file price-posting schedules bi-monthly. In West Virginia, schedules are filed quarterly. In Maryland, the price-posting filing schedule is at the state comptroller's discretion.

#### PRICE-POSTING FILING SCHEDULES

Terms of price-posting filing schedules vary among the states. In six states, they must be filed by the fifteenth day of the month preceding the month prices take effect. But, Georgia, Indiana, Maryland, and West Virginia do not specify an exact day lists must be submitted. Delaware and South Dakota permit the filing of price-posting schedules during the second half of the month preceding the month prices take effect.

#### POST-OFF PROVISIONS

Post-off provisions (a price reduction not tied to quantity of alcohol purchased by the individual retailers) are permitted in Delaware, Missouri, New Jersey, New York, and West Virginia. They are not permitted in Georgia, Massachusetts, Oklahoma, and South Dakota. Connecticut, Indiana, and Maryland's laws do not address post-off provisions.

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<sup>9</sup> California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc. 445 US 97 (1980).

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#### PRICE CHANGES

The following nine states allow wholesalers to change prices at various times in the month preceding the month changes are to occur: Connecticut, Delaware, Georgia, Indiana, Missouri, New York, Oklahoma, South Dakota, and West Virginia. In Maryland and Massachusetts, price changes are allowed at the discretion of the state's alcoholic beverage governing agency. New Jersey does not permit price changes.

#### PRICE DISSEMINATION

Five states-Connecticut, Delaware, Massachusetts, Oklahoma, and West Virginia-require price dissemination by either direct mail or publication in an applicable trade journal. Georgia, Indiana, Maryland, Missouri, and New York do not address price dissemination. New Jersey and South Dakota do not require price dissemination, but wholesalers in both states typically follow the practice voluntarily.

The 38 license states are: Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, the District of Columbia, Florida, Georgia, Hawaii, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Jersey, New York, North Dakota, South Dakota, Oklahoma, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, West Virginia, Wisconsin, and Wyoming.

**TABLE A1**  
**Price Posting Laws in Twelve States**

	<i>Price-posting filing schedule</i>	<i>Terms of price-posting filing schedule</i>	<i>Post-off provisions (a price reduction not tied to quantity purchased)</i>	<i>Opportunity to change prices</i>	<i>Price dissemination</i>
<b>Connecticut</b>	Monthly	By the 12 <sup>th</sup> day of each month. Prices take effect on the first day of the month following filing.	Not specified	Yes. Must be filed before 3 p.m. of the fourth business day after the last day for posting prices.	Yes by direct mail and advertising in trade journal.
<b>Delaware</b>	Monthly	Not less than five business days prior to the end of the month preceding price change.	Permitted	Yes. Price changes may be made at any time, but notification must be made via hard copy or electronically and recorded on an "800" number.	Yes by direct mail and advertising in trade journal.
<b>Georgia</b>	Continuous	Not specified	Not permitted	Yes, but not within a period of less than 180 days from the date of the previous posting.	Not specified
<b>Indiana</b>	Continuous	Not specified	Not specified	Yes, but must be disseminated in such a manner and for such a period of time as is calculated to insure retailers are afforded reasonable opportunity to secure the advantage of the price change.	Not specified
<b>Maryland</b>	Comptroller's	Comptroller's	Comptroller's	Comptroller's discretion	Not specified

## Appendix I (1)

### Pricing Policies, and Price Post and Hold

	discretion	discretion	discretion		
<b>Massachusetts</b>	Bi-monthly	By the 10 <sup>th</sup> day of the month preceding the next scheduling period.	Not Permitted	Commission's discretion	Yes, by direct mail.
<b>Missouri</b>	Monthly	On or before the 10 <sup>th</sup> calendar day of each month, unless otherwise ordered.	Permitted	Yes, within three days of filing monthly report.	Not specified
<b>New Jersey</b>	Monthly	By the 15 <sup>th</sup> day of each month.	Permitted	Not permitted	Not required
<b>New York</b>	Monthly	On or before the fifth day of each month.	Permitted	Permitted. Prices must be changed within three days of authorities release of report.	Not specified
<b>Oklahoma</b>	Bi-monthly	On or before 15 <sup>th</sup> day of month preceding period.	Not permitted	Yes. Must be filed by 25 <sup>th</sup> day of month preceding period.	Required by direct mail or trade journal.
<b>South Dakota</b>	Continuous. New products and price changes.	10 days prior to sale.	Not permitted	Permitted. Not less than 10 days after filing unless reduction is in response to a competitor's price change.	Not required
<b>West Virginia</b>	Quarterly	February, May, August and November. No specific day.	Permitted	Permitted. Must be filed 60 days before price change.	Required in trade journal.

## Appendix I (1)

### Pricing Policies, and Price Post and Hold

#### APPENDIX D: Current System Impact Assessment

NOTE: This impact assessment is based on feedback received from industry participants, a brief review of relevant materials and research literature. It is not intended to provide an exhaustive assessment of all potential impacts. The impacts identified have not been thoroughly tested or evaluated.

CONSUMER <i>(price, convenience, selection)</i>	BUSINESS <i>(costs, unnecessary market restrictions, revenues, private employment)</i>	STATE <i>(state resources, state sales and tax revenues, state employment)</i>	SOCIETY <i>(alcohol misuse, youth access to alcohol, environmental pressures encouraging misuse)</i>
Higher prices	Burdensome, inflexible, lost market opportunities	Aids enforcement efforts	Possible reduction in abusive consumption

#### A. Impacts on Consumers *(price, convenience, selection)*

By limiting competition, price posting results in higher prices to consumers. And restrictions on price changes interfere with market signals and are likely to result in higher prices (as in the case of restrictions on price decreases) or reduced output (as in the case of restrictions on price increases).

#### B. Impacts on Business *(costs, unnecessary market restrictions, revenues, private employment)*

According to industry participants interviewed in focus groups, manufacturers, retailers and independent wholesalers felt the “post and hold” requirements place an undue burden on their business, and the data gathered is not useful. They felt the data entry required by the system is overly burdensome and the enforcement is inflexible. If an error is made in data entry it is difficult at best to change the entry, and the business could face stiff penalties for an innocent error. The time delay between submitting the posted price and the next ability to change price is too lengthy. For manufacturers, from the time the price is posted to the time a price change will show up in the market can be well over 60 days. The interviewees do not use the pricing data in the system to track their competitor’s prices, and they do not believe the LCB actively uses the information.

#### C. Impacts on the State *(state resources, state sales and tax revenues, state employment)*

The LCB believes the state benefits from the “post and hold” requirements because taken together they make the bans on quantity discounts, credit sales, and uniform pricing easier to enforce and more difficult to evade. The regulations tend to prevent price wars that could result in lower beer / wine prices.

If the post and hold regulations do indeed keep prices high, and there is a causal link established between price and consumption, there may be some revenue loss to the state from lost sales due to higher prices. This may be offset somewhat by the reduction in costs to the state associated with abusive consumption.

## Appendix I (1)

### Pricing Policies, and Price Post and Hold

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#### D. Impacts on Society



*(alcohol misuse, youth access to alcohol, environmental pressures encouraging misuse)*

If the post and hold regulations do tend to maintain higher prices, and a causal link can be established between price and consumption, there may be some benefit to society from reduced abusive consumption.

## **Appendix I (2)**

### **LCB Retail Regulations for Beer and Wine**

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Appendix I (2)  
\* \* \* Issue Paper Developed to Inform the Task Force \* \* \*  
Policy Assessments, Impact Assessments and Potential Options were drafted to spark  
discussion and were not necessarily adopted or confirmed by the Task Force

**LCB Retail Regulations for Beer and Wine**

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**EXECUTIVE SUMMARY**  
**LCB Retail Regulations for Beer and Wine**

**ISSUE STATEMENT:**

*Some retailers believe the LCB has an unfair pricing advantage because it is not required to follow the same set of regulations for wine and beer sales as private retailers.*

- *Does the LCB sell wine and beer at an unfair price advantage in state stores?*
- *Should the regulations pertaining to wine sales for the LCB be changed?*

**BACKGROUND:**

- The LCB has been a wine retailer since its creation in 1934.
- In 1969, changes in the law allowed wine to be sold through private retailers. Since then, the number of private retail outlets where wine is sold has increased significantly.
- Retailers are concerned the LCB has an unfair pricing advantage in the sale of wine and beer.
  - Many retailers attribute this advantage to the fact the LCB is not subject to the same regulatory constraints as private retailers.
  - The LCB is subject to other constraints, however, which limit the LCB's ability to compete in wine market.
- In 2005, in response to concerns raised by the private retailers, the LCB increased its mark-up on wine to more closely reflect average private sector retail prices. As a result, wine sales have declined in state stores but recovery of market share is expected.
- The LCB currently holds a 7.1% market share in the sale of wine, down from 8.2% in FY 2005. The LCB has determined it will limit its market share to 10% or less.
- The LCB reports the state receives over \$11 million in annual net revenues from the sale of wine and beer in state and contract liquor stores.
- The current system is thought to have a generally positive impact on consumers and the state, and has both a negative and positive impact on private business. The impact on society is largely neutral.

**POTENTIAL OPTIONS FOR LCB IN COMPETITION FOR WINE AND BEER SALES:**

1. Continue the current price strategy of maintaining a 43% markup and keep the LCB market share below 10%. (This represents "no change" from the existing pricing policy that was put in place in October 2005) (no impact, but continued frustration of private retailers).

## Appendix I (2)

### LCB Retail Regulations for Beer and Wine

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2. Require the LCB to sell no lower than the minimum price allowed of other retailers (+ solves competition and policy strategy inequity issues, could provide additional revenue to the state, but – does not address the fact that the LCB still has other advantages associated with fewer constraints)
3. Rescind the LCB's authority to sell beer and wine in state stores (+ eliminates competition for private retailers, - reduces state sales revenue, reduces customer convenience, eliminates a primary distribution channel for some small wineries)

Appendix I (2)  
LCB Retail Regulations for Beer and Wine

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## LCB Retail Regulations for Beer and Wine

**Reference** for current law/rule/practice: RCW 66.

### I. BRIEF ISSUE STATEMENT AND CORRESPONDING QUESTION:

Some retailers believe the LCB has an unfair pricing advantage because it is not required to follow the same set of regulations for wine and beer sales as private retailers.

- Does the LCB sell wine and beer at an unfair price advantage in state stores?
- Should the regulations relating to the LCB retail operations for wine and beer sales be changed?

### II. DESCRIPTION OF CURRENT ENVIRONMENT:

The LCB is the exclusive retailer of spirits in Washington State. However, sales of lower-alcohol content wine and beer are licensed to a wide variety of retail. The state stores also carry wine and beer products.<sup>1</sup>

#### **The LCB has been a wine retailer since its creation at the end of prohibition.**

- Originally, the state was the only channel for the sale of out-of-state wine. Wines produced in Washington, however, could be sold in grocery stores and other retail outlets.
- In 1969 the law was changed to allow out-of-state wine to be sold in grocery stores and other private venues.
- Currently, 60% of the wine sold in Washington is sold in chain grocery stores. About 20% is sold in big-box stores. The remaining 20% is sold in beer and wine shops, neighborhood markets, convenience stores and state and contract liquor stores.
- According to the LCB, wine sales account for \$38 million of the \$650 million in gross sales achieved by state and contract liquor stores annually. It is difficult to estimate the percentage of revenue returned to the state based on wine sales in state and contract stores. However, somewhat more than \$11 million of the \$263 million returned annually to the state from the LCB can be attributed to wine sales.

#### **The number of retail outlets where wine is sold has increased significantly.**

- In 1969 there were 273 LCB retail stores.
- Today, there are 161 state stores, 154 contract liquor stores and the LCB licenses 4,814 off-premise retail outlets including grocery stores, convenience stores and specialty wine shops.

**At least five recent studies have addressed the topic of whether, and under what circumstances, the state should be selling beer and wine.** See *Appendix B*. These studies have generally concluded the state has an appropriate role in the sale of wine and beer, or at a minimum

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<sup>1</sup> This section draws heavily from the LCB's *Wine Program Strategy 2004-2009* and Dave Pavelchek's 2003 report, *A comparison of Wine Prices: State Liquor Stores and Major Grocery Chains*.

## Appendix I (2)

### LCB Retail Regulations for Beer and Wine

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have not recommended the state stop the sale of wine and beer. According to the LCB, the state remains in the wine business for the following reasons:

- Wine sales provide added convenience and customer service;
- Wine sales produce additional revenue for the state; and
- State stores have historically sold wine, and they provide an important marketing venue for small Washington wineries.

The LCB has determined it will limit its market share to 10% or less.

**In 2005, the LCB increased its mark-up on wine to more closely reflect average private sector retail prices.** In 2004, the LCB conducted a pricing survey, comparing the prices of its 100 top-selling wines to average prices of the same wines sold in retail outlets. The survey indicated that the state's prices were lower for 89 of the 100 wines. In an effort to achieve greater price parity with the private sector, in October of 2005 the LCB raised the mark-up on all wines sold in state stores from 38% to 43%. (This followed a short-term price change that raised the prices of the 89 wines that were being sold at below-average retail prices.) *Appendix C describes the LCB's approach to wine pricing.*

**Wine sales have declined in state stores but recovery of market share is expected.**

Since the increased mark-up was implemented:

- The LCB's market share (of liters sold) dropped to 7.1% from 8.2% in FY 2005; and
- LCB wine sales dropped more than \$2 million (a nearly 6% decline) between July 2005 and May 2006.

The LCB reports wine sales are stabilizing, and ultimately the board anticipates recovering to a market share near the agency's established 10% market share limit. (*See Board Wine Pricing and Market Share Issue Paper, July 12, 2006.*)

### III. ISSUES RAISED BY INDUSTRY STAKEHOLDERS

**During Focus Group interviews, many retailers expressed concern that the LCB has an unfair pricing advantage in the sale of wine and beer.**

- Private retailers are subject to a variety of regulatory constraints, designed to further the state's goals of preventing the misuse of alcohol, promoting the efficient collection of taxes and providing for the orderly distribution of alcohol.
  - Key constraints identified by interview participants include: requirement to purchase wine at posted prices, prohibition on quantity purchase discounts, prohibition on central warehousing, prohibition against purchasing product on credit from distributor, and a mandatory minimum markup on purchases.
- Private retailers largely agree the regulatory constraints do result in higher prices to the consumer, because they increase the retailer's business costs, which then must be passed along to the consumer.

## Appendix I (2)

### LCB Retail Regulations for Beer and Wine

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- Retailers are concerned that the LCB can sell wine and beer at an unfair price advantage because it operates state and contract liquor stores under a different set of constraints than those in effect for private retailers.
  - Constraints on Private Wine Sellers:
    - Must procure product from licensed supplier or distributors.
    - Product is subject to a 10% minimum markup.
    - Cannot receive quantity discounts on products.
    - May not purchase product on credit.
    - Price posting and one-month holds on prices limit flexibility.
    - May not operate a central warehouse facility.
  - Constraints on State Stores:
    - State is prohibited from advertising outside its stores.
    - Store hours are limited.
    - By internal policy, state wine prices are set for a three-month period.
    - The state may not sell non-alcoholic products in its stores.
- In addition, retailers see the state's ability to offer lower prices as inconsistent with the state's stated rationale of maintaining higher prices as a means of reducing abusive consumption.
- Many retailer focus group participants felt the state should either have to "play by the same rules" as their private sector counterparts, or it should get out of the business of selling wine and beer altogether.
- **Not all private sector participants in the wine industry are unhappy with the LCB as a wine retailer.** According to some wine producers, the LCB provides a crucial outlet for their product.

Note: Although the state liquor stores are also allowed by law to sell beer, the issue has been of much lesser concern because the quantity and selection carried by state stores is negligible. The following discussion, therefore, is directed only to wine sales.

## IV. CONTRIBUTION TO THE STATE'S POLICY GOALS

### 1. Does LCB's involvement in the retail sale of beer and wine contribute to the state's policy goal of preventing the misuse of alcohol? If yes, how?

No. If the state were the only retailer of beer and wine, the argument might be made that the state is preventing misuse by limiting access to beer and wine. But private retailers are licensed to sell beer and wine so the state's involvement can rather be seen as increasing access to these products. And, since the state's prices are often on the low end, and at times lower than, private retail prices the state is not preventing misuse of alcohol through higher prices.

### 2. Does LCB's involvement in the retail sale of beer and wine contribute to the state's policy goal of efficient collection of taxes? If yes, how?

## Appendix I (2)

### LCB Retail Regulations for Beer and Wine

It neither hinders nor contributes to this policy goal.

### 3. Does this regulation promote the state's policy goal of fostering the orderly and responsible distribution of malt beverages and wine towards effective control of consumption? If yes, how?

It neither hinders nor contributes to this policy goal.

## V. CURRENT SYSTEM IMPACT ASSESSMENT

NOTE: This impact assessment is based on feedback received from industry participants and a review of relevant documents and literature. It is not intended to provide an exhaustive assessment of all potential impacts. The impacts identified have not been thoroughly tested or evaluated.

CONSUMER (price, convenience, selection)	BUSINESS (costs, unnecessary market restrictions, revenues, private employment)	STATE (state resources, state sales and tax revenues, state employment)	SOCIETY (alcohol misuse, youth access to alcohol, environmental pressures encouraging misuse)
<ul style="list-style-type: none"> <li>Potential for lower prices</li> <li>Convenience of one-stop shopping</li> <li>Increased selection</li> </ul>	<ul style="list-style-type: none"> <li>Some retailers may be losing business</li> <li>Some producers may be getting product placement that would otherwise be unavailable</li> </ul>	<ul style="list-style-type: none"> <li>Increased revenues</li> <li>Ability to better serve customers</li> <li>Supports development of the state's wine industry</li> </ul>	<ul style="list-style-type: none"> <li>Potential for small increase in access because of lower prices and more outlets</li> </ul>

See Appendix D for a detailed discussion of the Current System Impacts Assessment.

## VI. POLICY OPTIONS FOR CONSIDERATION

**NOTE:** These options are offered to stimulate discussion. **They are not necessarily the best or only alternatives available.** The analysis of potential benefits and drawbacks represents our best efforts at assessing impacts based on feedback received from industry members, and a brief review of relevant literature. They have not been thoroughly tested or evaluated.

	Consumers	Business	State	Society
Option 1	NC	NC	NC	NC
Option 2	--	+/--	+	NC
Option 3	+	+	+	--

### Option 1: Continue the current price strategy of maintaining a 43% markup and keep the LCB market share below 10%. (This represents “no change” from the existing pricing policy that was put in place in October 2005.)

Potential benefits: No impact to state revenues, consumer purchasing patterns or options, and no impact on LCB employment.

## Appendix I (2)

### LCB Retail Regulations for Beer and Wine

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Potential drawbacks: Private retailers may continue to be frustrated over the perceived inequities in the current regulatory structure.

#### **Option 2: Require the LCB to sell no lower than the minimum price allowed of other retailers.**

This option would likely result in the following changes:

Potential benefits: Higher wine prices in state liquor stores may result in reduced purchasing and therefore, presumably, consumption. The state receives more sales revenue if prices are raised. Private retailers are satisfied that the state does not have a competitive advantage.

Potential drawbacks: This option would likely result in higher prices for wine at state liquor stores for consumers. Wine retail sales may decrease, with a potential decrease in state sales revenue.

#### **Option 3: Rescind the LCB's authority to sell beer and wine in state stores.**

Potential benefits: Private retail sales would increase. Sales overall may be slightly reduced because customers purchasing both wine and spirits would need to make two separate trips. Instead, they may choose to either substitute one for the other (double their purchase of wine and forego spirits, or vice versa), or they may simply decide not to make the second purchase in which case overall purchases (and thus consumption) would be reduced.

Potential drawbacks:

- State revenues would be reduced.
- Consumer convenience would be reduced.
- Wine producers may lose revenue due to decreased sales if consumers do not replace their state store wine purchases with private retail purchases. (Some consumers may substitute additional spirits purchases.)
- Some in-state smaller wine producers may lose revenues or go out of business because they are unable to market their product effectively in private sector stores.

**Appendix I (2)**  
**LCB Retail Regulations for Beer and Wine**

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**APPENDICES**

**A – Background**

**B – Recent Studies Addressing the State’s Role in Retail Wine Sales**

**C – LCB Wine Pricing Practice**

**D – Current System Impact Assessment**

## Appendix I (2)

### LCB Retail Regulations for Beer and Wine

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#### APPENDIX A

##### Background

The Washington State Liquor Control Board (LCB) was established in 1933 to control the flow of alcohol in Washington State through licensing and enforcement of alcohol-related regulations and by managing state liquor stores. (RCW Chapter 66). The LCB is also responsible for monitoring and collecting Washington State alcohol license fees and sales tax revenue.

The LCB directly manages 161 state liquor stores and contracts for management of 154 stores selling spirits, beer and wine. In 2005, the LCB licensed and monitored 12,331 retail licensees including: 4,814 retail outlets that sell alcohol for off-premise consumption, 7,274 restaurants, taverns, and sports/entertainment facilities for on-premise alcohol consumption, and 243 bed & breakfast and other retail licensees. The LCB also licensed and monitored 1,690 non-retail licensees: 183 distributors and importers, 353 in-state wineries, 84 in-state breweries, 960 out-of-state wineries and breweries, and 110 other licensees (bonded wine warehouses, liquor manufacturers, wine growers, CCI and ship handlers).

Through licensing and a comprehensive set of regulations, the LCB is responsible for enforcing the applicable laws, rules and policies that support the state's goals to prevent the misuse of alcohol, efficiently collect taxes and provide for orderly distribution of alcohol.

The LCB carries out its enforcement duties through three divisions, Enforcement and Education (85 Liquor Enforcement Agents) Licensing and Regulation, and Manufacturers, Importers and Wholesale (MIW) (5 FTEs).

In addition to its control and enforcement roles, the LCB manages and contracts with 315 state liquor stores, providing sales revenue to the state, along with the tax revenue from all alcohol sales.

Licensing and enforcement were not part of the scope of the three-tier study. However, there were a number of issues for potential change identified by interview participants that fall into this category. The Task Force rated several of these items as the highest priority for change.

## Appendix I (2)

### LCB Retail Regulations for Beer and Wine

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#### APPENDIX B

##### Recent Studies Addressing the State's Role in Retail Wine Sales

- In 1983, the Office of Financial Management explored the issue of whether the state should be in the business of retail liquor sales.<sup>2</sup> In that study, the more specific issue of whether the state should be selling wine and strong beer at the retail level was considered. The OFM study included in its appendix a review by the Legislative Budget Committee (LBC, now the Joint Legislative Audit and Review Committee). The financial analysis conducted at that time led the LCB study team to conclude that the state should continue.
- In 1995, prompted by declining sales of wine in state stores, the Board conducted a review of the state's wine program. The board considered the option of eliminating wine from its retail inventory, but instead determined that improvements should be made to the program. As a result of this study, the LCB hired a wine program manager, and began the development of a wine retail strategy.
- The issue of whether the state should be in the business of selling wine in its retail stores came up again in 2000 as part of a study conducted by the Washington State Retail Liquor Sales Task Force. The final report states that, although no clear consensus on recommendations was reached by the Task Force members, they did agree there was a need to address "fair practices" in this area.

Two additional pricing studies were completed in the last few years.

- In December 2003, a Washington State University study concluded that when considering regular and sale prices, the LCB's prices are significantly toward the low end of the price distribution, while not significantly lower than the lowest grocery store prices. However, when "member club" prices are included in the analysis, LCB prices are competitive, but within the range of prices offered by retail grocers.
- In 2004, a study was conducted of the top selling 100 wines, comparing LCB prices with the average retail prices. The LCB was selling 89 of the 100 wines under the average retail price by an average of 13%. As a result, the LCB raised its markup from 38% to 43% to more closely reflect average retail prices.

Fiscal Year	Wine Sales	LCB Liters	Market Share	% Markup
2001	\$36,802,779.00	6,236,266	9.6%	38
2002	\$38,039,620.00	6,449,392	9.8%	38
2003	\$39,045,711.00	6,612,116	9.0%	38
2004	\$38,144,333.00	6,464,827	8.3%	38
2005	\$38,891,883.00	6,505,885	8.2%	38 / 43

\* Top 100 in effect, 1/2005-6/2005

Source: Steve Burnell, LCB Wine Program Manager

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<sup>2</sup> *The Desirability of Continuing Retail Liquor Sales by State Government*, Office of Financial Management, July 1983, pp. 61-31, pp. 151-165.

## Appendix I (2)

### LCB Retail Regulations for Beer and Wine

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#### APPENDIX C

##### LCB Wine Pricing Practice

The LCB can purchase wines either directly from a supplier (such as a wine manufacturer) or through a wholesaler. The supplier or wholesaler is not required to sell to the LCB at their posted price. They can offer their product at any price they determine is appropriate.

The LCB sets prices on wine products through a “mark up” formula. This methodology begins with a base price quoted from the producer or wholesaler (federal taxes are included in the base price), and a freight charge is added on. The state’s markup (currently 43%) is then applied. To that, the state wine liter tax of \$0.2292 per liter (\$0.4536 for wines with an alcohol content over 14% -- typically fortified wines) and a per-case surcharge of \$1.80 are added. The result is the final retail price. The state liquor stores change their wine prices every three months. This practice reduces the administrative expenses of price changes (labor involved in swapping out shelf labels, and price list printing costs, for example.)

When a supplier offers the LCB product at a sale price, the LCB may offer that product to consumers at a “temporary price reduction” (TPR). Like all wine prices, the LCB only changes its TPRs every three months.

<b>LCB Wine Pricing Formula</b> <b>Illustrating a typical 750 ML bottle of wine</b>	
Supplier / Wholesaler price to LCB	\$ 10.00
Outbound Freight	\$ 1.44
Subtotal	\$ 11.44
43% Markup	\$ 4.92
Subtotal	\$ 16.36
Wine Liter Tax (\$0.2292 per liter)	\$ 0.17
Per-Case Surcharge	\$ 1.80
<b>TOTAL</b>	<b>\$ 18.33</b>

## Appendix I (2)

### LCB Retail Regulations for Beer and Wine

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#### APPENDIX D

#### Current System Impact Assessment

NOTE: This impact assessment is based on feedback received from industry participants and a review of relevant documents and literature. It is not intended to provide an exhaustive assessment of all potential impacts. The impacts identified have not been thoroughly tested or evaluated.

##### A. Impacts on Consumers (*price, convenience, selection*)

**Positive**

- State liquor store prices may be lower than private retailers.
- Making wine available at state liquor stores is a convenience for customers who chose to purchase wine and spirits in one location.
- The LCB asserts its emphasis on Washington wines provides an outlet for some wines that otherwise may not be competitive if only offered through a wholesaler, and provides general support for the Washington wine industry. As a result consumers may benefit by a broader array of wines.

##### B. Impacts on Business

**Negative**

**Positive**

##### (*costs, unnecessary market restrictions, revenues, private employment*)

- Private wine retailers believe they are losing sales to the state liquor stores because the regulatory structure under which the state stores operate provides a significant pricing advantage.
- Some smaller, in-state wine producers might have a difficult time finding a market for their product, and difficulty in distributing their product. The LCB's support of Washington wine industry has likely provided some support to these entities.

##### C. Impacts on the State

**Positive**

##### (*state resources, state sales and tax revenues, state employment*)

- The state receives increased revenue from the sale of wine and beer in state liquor stores. (In addition to tax revenues, the state also collects the markup.)
- Some smaller, in-state wine producers may have a difficult time finding a market for their product, and difficulty in distributing their product. The LCB's support of Washington wine industry has likely provided some support to these entities. In addition, the LCB annual in-store promotions highlight Washington wines.

## Appendix I (2)

### LCB Retail Regulations for Beer and Wine

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#### D. Impacts on Society

Neutral

*(alcohol misuse, youth access to alcohol, environmental pressures encouraging misuse)*

- Lower prices in state liquor stores may stimulate slightly higher purchasing rates, than if sold at a higher price. However, it is difficult to know whether the discouraged purchaser simply purchased the same product elsewhere.
- Added convenience of being able to purchase both wine and spirits in one location may contribute to slightly higher rates of purchase in cases where a consumer had not intended to purchase both spirits and wine but was stimulated by the availability of the product at the liquor store.

## **Appendix I (3) Issue Papers: Compelled Use of Distributors**

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Appendix I (3)  
\* \* \* Issue Paper Developed to Inform the Task Force \* \* \*  
Policy Assessments, Impact Assessments and Potential Options were drafted to spark  
discussion and were not necessarily adopted or confirmed by the Task Force  
**Compelled Use of Distributors**

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**EXECUTIVE SUMMARY**  
**Compelled Use of Distributors**

**ISSUE STATEMENT:**

*Some industry participants believe the mandated use of a distributor is unnecessary; that the laws too heavily favor the distributor by limiting a business's ability to negotiate appropriate service levels; and that the regulatory scheme governing these relationships protects distributors business interests while unnecessarily hindering manufacturers' and retailers' businesses, without promoting state policy goals. **These industry representatives believe laws explicitly and implicitly mandating the use of distributors should be eliminated permanently.***

*Others believe that the traditional distributor tier continues to play a vital role in maintaining separation of interests across the tiers and their ability to assist the state in its efforts to collect taxes and monitor the flow of alcohol into the state are central to achieving the state's policy goals. **These industry participants believe the three-tier system should not be eroded.***

**DISCUSSION:**

The distributor tier was originally inserted into the supply chain as one means of separating the tiers. Many participating industry stakeholders feel the state's regulatory structure strongly favors the distributor. These individuals favor a more flexible approach that allows the supplier and distributor (or retailer and distributor) to negotiate the extent of their relationship based on a business need.

**Exceptions over time have essentially made it technically possible for all manufacturers to physically distribute beer and wine to licensed retailers. However, industry participants report that related regulations make it very difficult NOT to use a traditional distributor for the physical distribution of products.** Two areas were noted as particular concerns.

- Although retailers can contract with common carriers to have product shipped to them, manufacturers do not have this same authority.
- Retailers' lack of ability to centrally warehouse beer and wine products makes self-distribution economically infeasible.

Although both of these requirements apply to traditional distributors as well, industry representatives felt they do not present the same level of barrier to traditional distributors that they do to manufacturers that want to use the self-distribution authority.

**It is unclear what the impact will be of expanding the authority to self-distribute to out-of-state wineries and breweries.**

- Distributors and policy makers are concerned that eliminating (or reducing) the compelled requirement to sell product through a licensed distributor will significantly and negatively impact the beer and wine distribution industry in Washington.

## Appendix I (3)

### Compelled Use of Distributors

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- In-state manufacturers who currently use distributors, however, reported they would continue to use a distributor because they wanted to maintain their focus on their core mission – to produce beer or wine. Distributors provide valuable services, both to manufacturers and to retailers.
- Distributors and policy makers are also concerned that expanding the authority to act as distributors will make it more difficult to ensure that sales are reported and excise taxes are paid.
- Prevention, treatment and law enforcement stakeholders and some distributors, are concerned that any degradation to the existing three-tier system may have significant and negative consequences to public health and safety.

To date, there have been 51 direct shipment endorsement applications from out-of-state manufacturers received by the WSLCB. **Since the new regulations did not become effective until July 2006, there is insufficient information available to analyze its actual impacts.**

#### **CURRENT REGULATIONS CONTRIBUTION TO STATE POLICY GOALS:**

1. **Does the state's current regulatory structure related to the compelled use of distributors (and exceptions) contribute to the state's policy goal of preventing the misuse of alcohol?** Yes. The compelled use of distributors was originally initiated, in part, to allow for careful monitoring of the flow of alcohol, and it does contribute to that goal.
2. **Does the state's current regulatory structure related to the compelled use of distributors contribute to the state's policy goal of efficient collection of taxes?** Yes. As originally implemented and as modified to allow in-state manufacturers to self-distribution, current regulations have supported efficient tax collection – or at least, there is no evidence to the contrary.
3. **Does the state's current regulatory structure related to the compelled use of distributors promote the public interest in fostering the orderly and responsible distribution of malt beverages and wine towards effective control of consumption?** Yes, and no evidence has been collected that demonstrate the limited exceptions allowing in-state manufacturers to self-distribute have had either a positive or negative impact on this goal.

## Appendix I (3)

### Compelled Use of Distributors

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#### POTENTIAL POLICY OPTIONS:

**OPTION 1: No Change.** Leave existing authority for distribution and self-distribution in place, with no further expansion of authority, and no modification to supporting regulations.

Potential Benefits: Provides an efficient and effective means to monitor the flow of beer and wine and to collect taxes. Gives the state time to see to what extent out-of-state manufacturers will self-distribute, and what, if any, impacts will result. As the “known” model there is less risk of unintended consequences.

Potential Drawbacks: Use of additional authority may be limited, and some industry participants’ business models are still constrained. Consumer prices may be higher under this model.

**OPTION 2: Eliminate regulations that act as barriers to using self-distribution authority.**

Potential Benefits: Could expand the use of self-distribution options, and introduce additional market influence, and as a result could reduce price to consumers.

Potential Drawbacks: Could result in increased illegal or unreported sales if not accompanied by appropriate reporting and enforcement mechanisms.

**OPTION 3: Move toward complete elimination of mandated requirements to use traditional distribution tier.**

Potential Benefits: Allows market forces to drive the level of service provided in the distribution chain and could result in lower prices.

Potential Drawbacks: A more diffused system could make monitoring, enforcement and revenue collection difficult, and make it easier to sell or move product illegally.

## Appendix I (3)

### Compelled Use of Distributors

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#### RELATIONSHIP AMONG THE TIERS

##### Compelled Use of Distributors

**References:** Chapter 302, Laws of 2006 (Second Substitute Senate Bill 6823); RCW 66.24 & 66.28

#### ISSUE STATEMENT:

*Some industry participants believe the mandated use of a distributor is unnecessary; that the laws too heavily favor the distributor by limiting a business's ability to negotiate appropriate service levels; and that the regulatory scheme governing these relationships protects distributors business interests while unnecessarily hindering manufacturers' and retailers' businesses, without promoting state policy goals. These participants indicate:*

- *They would likely continue to use distributors extensively (except for the minority who exclusively self-distribute), but their use should be driven by business necessity (added value), not by mandate.*
- *Related regulations such as a prohibition on central warehousing and prohibition on the use of common carriers by manufacturers effectively negate any expanded authority such as self-distribution by manufacturers.*

*These industry representatives believe laws explicitly and implicitly mandating the use of distributors should be eliminated permanently.*

*Others believe that compelled use of distributors, and related regulations, should not be eroded. These industry participants believe:*

- *The traditional distributor tier continues to play a vital role in maintaining separation of interests across the tiers and their ability to assist the state in its efforts to collect taxes and monitor the flow of alcohol into the state are central to achieving the state's policy goals.*
- *Relaxing the requirements mandating the use of a distributor could result in loss of tax revenues, inability to monitor the flow of alcohol into the state, and ultimately would increase illegal sales and abusive consumption of beer and wine.*

*Should the state mandate the use of licensed distributors for the sale of beer and wine, or should the state move toward the eventual elimination of the compelled use of distributors, including related prohibitions that effectively require their use?*

#### BACKGROUND:

**Washington, like most states, has established a three-tier system for the distribution and sale of beer and wine.** As a general rule, suppliers<sup>1</sup> have been prohibited from selling beer and wine products directly to retailers. When the system was established, a middle distribution tier was inserted by the state to ensure the physical and economic separation of suppliers and retailers. This requires that suppliers sell their product to a licensed distributor, and only licensed distributors are allowed to sell to retailers, who in turn sell to consumers.

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<sup>1</sup> Suppliers generally include manufacturers, certificate of approval (COA) holders, authorized representatives, and importers.

## Appendix I (3)

### Compelled Use of Distributors

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As has been discussed in previous task force meetings, before Prohibition, it had become common practice for alcohol retailers to be closely controlled by large distillers and brewers, in effect to become “tied” to the more economically powerful suppliers. Control took the form of leases, chattel mortgages, credit and other financial interests. This control by the supplier level forced retailers to adopt programs to promote consumption and increased sales. These tied-houses sponsored activities and fostered levels of beverage alcohol consumption that offended the moral and social values of many of the communities in which they were located. In other words, the suppliers’ hands-on involvement in the retailing of alcohol created financial incentives to increase alcohol sales to levels that were perceived to be excessive and detrimental to both consumers and society as a whole.<sup>2</sup>

**Early in the development of Washington’s system, an exception was granted to allow in-state wineries, breweries and microbreweries to sell their own product directly to retailers,** and to retail their own product as well. When an in-state manufacturer is acting as a distributor, it must comply with all the regulations that apply to traditional beer and wine distributors, including for example, adding the appropriate distributor level mark-up to their product price, and posting their distributor prices. No attempt has been made over the years to demonstrate the impact these exceptions have had in the state. Therefore, there is no evidence to suggest whether these limited exceptions have had negative or positive impacts on the state’s ability to achieve its policy goals. *[It should be noted that “no evidence” does not mean “no impact.” In this context, it simply means that no evidence has been gathered that is sufficient to either support or refute assertions about impacts.]*

**In 2006, the Legislature extended this “self-distribution” authority to out-of-state wineries and breweries** (commonly referred to as “certificate of approval” holders or COAs).<sup>3</sup> The new statute requires COAs to obtain a direct shipment endorsement to act as a distributor, and the statute also allows retailers to contract with a common carrier to obtain products from these manufacturer/ distributors. (The manufacturer is still prohibited from contracting with a common carrier to distribute their product.) At the time the bill was passed, there were 714 COAs and the LCB anticipated that all 357 would seek direct shipment endorsements.

**The expanded authority does not extend to other suppliers** such as authorized representatives (authorized representatives are representatives of out-of-state or out-of-country wineries and breweries); importers (companies that import beer and wine from other countries) or COAs that do not have a direct shipment endorsement. And, **the “self-distribution” authority granted to out-of-state manufacturers expires on June 30, 2008.**

## DISCUSSION:

The issue of compelled use of distributors is an extremely complex topic and, to some extent, touches on virtually every significant issue associated with the three-tier system. **This issue paper focuses specifically on the business issues related to the physical distribution of beer and wine by manufacturers to retailers; it does not address all of the specific regulations that**

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<sup>2</sup> *Alcohol Distribution Laws Bottle Up Options for Consumers and Retailers*, Morgan Smith, Georgia Public Policy Foundation (October 16, 2002).

<sup>3</sup> Second Substitute Senate Bill 6823, Chapter 302, Laws of 2006.

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### Compelled Use of Distributors

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apply to distribution itself (i.e. tax reporting, mandatory mark up, delivered pricing, etc.), or the prohibition of retailer to retailer sales.

In brief, the distributor tier was originally inserted into the supply chain as one means of separating the tiers, tracking distribution and efficiently collecting taxes. Exceptions over time have essentially made it technically possible for all manufacturers (not including importers and authorized representatives) to physically distribute beer and wine to licensed retailers (while "standing in the shoes of a distributor" - abiding by the same essential regulations as a distributor would). However, several industry participants report that **related regulations make it very difficult NOT to use a traditional distributor for the physical distribution – particularly the ban on central warehousing, and the ban on use of common carriers by the manufacturer.**

**The distributor tier has traditionally played a vital role in the distribution chain.** Distributors often develop close working relationships with their suppliers and may work with the supplier on marketing issues. Distributors can also provide valuable services to retailers, such as assisting with restocking and promotions. Distributors are responsible for paying state excise tax on the beer and wine they purchase from suppliers. This tax remittance responsibility also ensures that the flow of beer and wine (particularly product from out-of-state) is accounted for and tracked through to the retail sale.

**Many participating stakeholders (including manufacturers, independent distributors and retailers) felt the state's regulatory structure that dictates the distributors' role, strongly favors the distributor, and makes it difficult or impossible for a business to negotiate a level of service appropriate to their business needs.** These individuals were in favor of a more flexible approach that allows the supplier and distributor (or retailer and distributor) to negotiate the extent of their relationship based on a business need, rather than being dictated by state regulations. To accomplish this, the requirement to use a traditional licensed distributor would need to be relaxed, and/or other related regulations changed, to allow some level of market competition.

**The legislature expanded the definition of who can act as a distributor, but related regulations reportedly make it difficult to use the expanded authority effectively.**

**The in-state exception has historically been used on a small-scale basis** and although a large number of in-state producers have used the authority to self-distribute, the volume of self-distributed product represents a small percentage of the beer and wine sold to Washington retailers. Appendix A shows a comparison of direct sales, which includes self-distribution sales, for FY 2001-2006 for both wine and beer.

- In Fiscal Year (FY) 2006, 93 of the 97 licensed in-state breweries (96%) sold product through direct sales (this includes self-distribution to retailers and sales to customers on their premises.) This represents 36% of all sales of beer produced in Washington, and 2% of all sales of beer (produced in Washington or elsewhere.)
- And, also in FY 2006, 315 of the 438 licensed in-state wineries (72%) licensed in Washington sold product through direct sales (this includes self-distribution to retailers and sales to customers on their premises.) This represents 17% of all sales of wines produced in Washington, and 8% of all sales of wine (produced in Washington or elsewhere.)

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### Compelled Use of Distributors

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During stakeholder interviews, winery and brewery operators reported the self-distribution option was particularly useful to them when their operation was new and/or they were producing a relatively small amount of beer or wine.

#### **Winery and brewery representatives cite two primary reasons for using self-distribution.**

- **First, self-distribution allows a smaller manufacturer to retain more of the profit.** Take for example a bottle of wine that costs \$10 to produce and is expected to retail at \$20. The winery may sell that bottle to a distributor for \$13, who then marks it up to \$17 and sells it to a retailer who sells it to a consumer at \$20. If the winery self-distributes, it can sell the bottle to the retailer directly at \$17 (or perhaps slightly cheaper to encourage the retailer to carry their product), and instead of keeping \$3 profit, they keep \$7 less the cost of marketing and delivering the product. For small entities this makes sense because they have a limited number of supply and customers, and therefore their marketing costs are somewhat low. As they grow, however, those costs increase as their retail base expands. Eventually it becomes inefficient for the winery or brewery to distribute their own product and they look for a distributor to take on those tasks.
- **Second, some winery and brewery representatives felt a large distributor would not adequately represent their account.** They noted that distributors, not unreasonably, tend to focus their time and energies promoting products that they can sell in larger volume. As distributors consolidate and become larger, and as the number of wineries and breweries expand, smaller manufacturers have a more difficult time competing for a distributor's promotional attention. Until a manufacturer has built up a level of demand from retailers it makes more sense to market their own product. (It should be noted that some distributors pointed out that although consolidation is occurring in the distributor tier, this has opened up opportunities for small, niche distributors that cater to the smaller "boutique" winery or breweries.)

In 2006, as a result of a court decision, the legislature expanded to out-of-state manufacturers the authority to also act as distributor of its own product. The changes provided in Second Substitute Senate Bill (2SSB) 6823 fundamentally alter the three-tier system in Washington.

**However, some industry representatives are concerned that the legislative change did not go far enough and it left in place barriers that make it difficult to use the new self-distribution authority.** Two areas were noted as particular concerns.

- **First, although retailers can contract with common carriers to have product shipped to them, manufacturers do not have this same authority.** The rationale used to explain this requirement is that when a common carrier is used, the state's ability to monitor or control its movement is limited, thus increasing the risk of illegal sales. Manufacturers, however, see this as an unnecessary impediment because it requires that either the manufacturer must ask the retailer to make the shipping arrangements, the retailer must pick up the product at the manufacturer, or the manufacturer must deliver it using a company vehicle.
  - Of the 18 states responding to the survey, nine states report they regulate the methods that may be used to deliver product to a retailer. These regulations appear to be quite varied. For example, Montana reports that breweries may not use common carriers, but in-state wineries may use common carriers for delivery while

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### Compelled Use of Distributors

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North Carolina allows manufacturers to deliver their own product or use a common carrier when distributing product to a wholesaler.

- **Second, the retailers' lack of ability to centrally warehouse beer and wine products makes self-distribution economically infeasible.** The ban on central warehousing is an obstacle to self-distribution. The fee structure of interstate commerce using a common carrier makes small deliveries cost prohibitive (reported by one retailer to be as high as \$300 per drop.) So if a carrier has to deliver to every store, it is too expensive to do and the retailer has to use a distributor. If they could ship to a central warehouse, they could then use their own trucks to deliver out to individual stores. Central warehousing would be more efficient for distributors, and better serves some of their clients. Removing this restriction would allow the market to determine the most efficient means of getting the product to the customer. Again, the argument against central warehousing has been that once the product is delivered to the central warehouse, the state loses control over the movement of the product, increasing the opportunity for illegal sales.
  - Of the 18 states responding with survey information, five states (California, Missouri, North Dakota, Texas and Wyoming [malt beverages only]) report they allow products to be delivered to a retailer's central warehouse.

**It should be noted that both of these requirements or limitations apply to traditional distributors as well. But many industry representatives felt these requirements do not present the same level of barrier to traditional distributors that they do to manufacturers that want to use the self-distribution authority.** (However, independent distributors also stated they would like the ability to use a common carrier on occasion and to deliver to a central warehouse.)

**It is unclear what the impact will be of expanding the authority to self-distribute out-of-state wineries and breweries. Many distributors and policy makers are concerned that eliminating (or reducing) the requirement to sell product through a licensed distributor will significantly and negatively impact the beer and wine distribution industry** in Washington. The LCB reports 148 distributors are currently licensed and do business in communities throughout Washington. (This figure does NOT include manufacturers who are also licensed to self-distribute.) According to state employment statistics, beer and wine wholesalers employed over 4,300 people in December of 2005, contributing roughly \$192 million in annual wages in 2005.<sup>4</sup> Any significant decrease in the use of traditional beer and wine distributors could have an economic impact on the state and on the communities in which they are located, at least in the short-term.

The in-state manufacturers who currently use distributors, however, reported they would continue to use a distributor because they wanted to maintain their focus on their core mission – to produce beer or wine. Distributors provide valuable services, both to manufacturers and to retailers. Although manufacturers (and retailers) felt that many of the regulations that support the three-tier

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<sup>4</sup> **These figures are approximate and are provided for illustrative purposes only.** The Employment Security Department (ESD) tracks employment and wages for all businesses that employ two or more people. The official quarterly employment and wage data reported by ESD for beer and wine wholesalers (NAICS Codes 42410 and 42420) for 2005 report the average employment for that year was 2,699 and total wages for the year were \$119,733,624. However, according to an ESD representative, a coding error was discovered that significantly increases both the total wages and employment. The figures provided in the text reflect an estimated correction for the coding error.

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### Compelled Use of Distributors

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system should be eliminated or made more flexible, the manufacturers interviewed all stated that distributors play a vital role and would continue to be used voluntarily.

**Distributors and policy makers are also concerned that expanding the authority to act as distributors will make it more difficult to ensure that sales are reported and excise taxes are paid.** Since distributors are licensed and located in the state, the WSLCB believes it has better ability to monitor and enforce tax collection than it would have with out-of-state entities. Thus, there is concern that the state's ability to ensure the appropriate level of taxes are collected is more difficult when dealing with an out-of-state entity. At least one stakeholder suggested shifting the collection of the excise taxes to retail level could eliminate the issue with having to collect taxes from out-of-state producers.

**Some stakeholders, particularly the prevention, treatment and law enforcement stakeholders, are concerned that any degradation to the existing three-tier system may have significant and negative consequences to public health and safety.** There has been significant support from the public health and safety segment of the industry to maintain the status quo. The concerns expressed generally reflect that too little is known about what might occur if the current approach to monitoring and enforcement is altered, and that we cannot know what type and extent of problems the existing system has successfully eliminated. However, as changes to the system occur, the state should closely monitor key public health and safety outcomes (such as youth consumption, DUIs and/or alcohol-related illnesses or injuries). If key indicators show that changes are having a negative impact, the LCB, the Legislature and the Governor should have mitigation plans in place that can be quickly implemented.

To date, 51 direct shipment endorsement applications from out-of-state manufacturers have been received by the WSLCB, and approximately 50 retailers have applied for the no-cost endorsement that allows them to purchase product through self-distribution. Since the new regulations were not implemented until July 2006, there is insufficient information available to analyze its actual impacts.

### **CURRENT REGULATIONS' CONTRIBUTION TO STATE'S POLICY GOALS:**

#### **4. Does the state's current regulatory structure related to the compelled use of distributors (and exceptions) contribute to the state's policy goal of preventing the misuse of alcohol? If yes, how?**

Yes. The compelled use of distributors was originally initiated, in part, to allow for careful monitoring of the flow of alcohol. To the extent that is accomplished, it does contribute to the goal of preventing misuse. Exceptions allowing in-state wineries and breweries to self-distribute and report on distribution of their own products have not produced evidence of increased misuse of wine or beer. The expanded authority for out-of-state manufacturers to self-distribute (2SSB 6823 provisions) has only been effective since July 2006 so it is unknown if this provision will impact the state's policy goals. (A separate issue paper and Task Force discussion will focus on the potential impacts of 2SSB 6823 and recommended impact measures.)

#### **5. Does the state's current regulatory structure related to the compelled use of distributors contribute to the state's policy goal of efficient collection of taxes? If yes, how?**

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Yes. As originally implemented and as modified to allow in-state manufacturers to self-distribution, current regulations have supported efficient tax collection – or at least, there is no evidence to the contrary. Extending the authority to self-distribute to out-of-state entities requires them to collect and report taxes, similar to in-state manufacturers. The expanded authority for out-of-state manufacturers to self-distribute (2SSB 6823 provisions) has only been effective since July 2006 so it is unknown if this provision will impact the state’s policy goals. (A separate issue paper and Task Force discussion will focus on the potential impacts of 2SSB 6823 and recommended impact measures.)

**6. Does the state’s current regulatory structure related to the compelled use of distributors promote the public interest in fostering the orderly and responsible distribution of malt beverages and wine towards effective control of consumption? If yes, how?**

Yes. The current regulatory structure seems to promote the orderly and responsible distribution of malt beverages and wine. There is no evidence that allowing in-state manufacturers to self-distribute has negatively impacted this goal. The expanded authority for out-of-state manufacturers to self-distribute (2SSB 6823 provisions) has only been effective since July 2006 so it is unknown if this provision will impact the state’s policy goals. (A separate issue paper and Task Force discussion will focus on the potential impacts of 2SSB 6823 and recommended impact measures.)

### CURRENT SYSTEM IMPACT ASSESSMENT:

*Note: This impact assessment is offered to stimulate productive discussion and is based on feedback received from industry participants, a brief review of relevant materials and research literature. It is not intended to provide an exhaustive assessment of all potential impacts. The impacts identified have not be thoroughly tested or evaluated.*

The following assessment reflects the impacts of the system now in place in which the majority of wine and beer is moved to market through the distributor tier, but allows both in-state and out-of-state manufacturers to self-distribute to retailers. (Note: Provisions for out-of-state manufacturers to self-distribute have only been in place for a brief time; it is difficult to know if these provisions will significantly impact the system.)

CONSUMER	BUSINESS	STATE	SOCIETY
<i>(price, convenience, selection)</i>	<i>(costs, unnecessary market restrictions, revenues, private employment)</i>	<i>(state resources, state sales and tax revenues, state employment)</i>	<i>(alcohol misuse, youth access to alcohol, environmental pressures encouraging misuse)</i>
Consumers may pay somewhat higher prices than they would if related regulations (e.g., central warehousing and delivery-related	Recent provisions for out-of-state manufacturers provide the same flexibility to self-distribute as in-state manufacturers have had for some	The state has been able to monitor and track the flow of alcohol and efficiently collect tax revenue. There has been no evidence provided that in-state	There is no evidence that the current distribution system either negatively or positively impacts society.

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### Compelled Use of Distributors

restrictions) were eliminated so that more manufacturers were able to take advantage of the new authority to self-distribute.	time and will likely result in additional self-distribution.  Related regulations and prohibitions on physical distribution do not provide sufficient flexibility to allow manufacturers or retailers to bypass the use of distributors for large distributions. Some manufacturers, retailers and independent distributors view this as a constraint on their business. The larger distributors prefer this model and believe changes could negatively impact their business and possibly employment.	self-distribution has created a problem for the state. There has not been enough experience to assess the impact of expanded provisions for out-of-state self-distribution.	
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## POLICY OPTIONS FOR CONSIDERATION

*NOTE: These options are offered to stimulate discussion. **They are not necessarily the best or only alternatives available.** The analysis of potential benefits and drawbacks represents our best efforts at assessing impacts based on feedback received from industry members, and a brief review of relevant literature. They have not been thoroughly tested or evaluated.*

	Consumers	Business	State	Society
<b>Option 1</b>	NC	NC	NC	NC
<b>Option 2</b>	+	+	--	--
<b>Option 3</b>	+	+	--	--

**OPTION 1: No Change. Leave existing authority for distribution and self-distribution in place, with no further expansion of authority, and no modification to supporting regulations.**

Potential Benefits: Use of distributors provides an efficient and effective means to monitor the flow of beer and wine and to collect taxes. Current provisions for monitoring flow and

## Appendix I (3)

### Compelled Use of Distributors

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tax collection of in-state self-distributors does not appear to have a negative impact, yet provides some flexibility for small manufacturers to get their product to market through alternative channels. The current expansion of out-of-state self-distribution (on a temporary basis) also gives the state additional time to see how many out-of-state manufacturers will self-distribute to Washington retailers, and what, if any, impacts will result. This is the known model; there is less risk of unintended negative consequences due to changes.

Potential Drawbacks: Without further modifications, use of the additional authority to self-distribute may be limited, and some industry participants' business models are still constrained. Consumer prices may be higher under this model than other models.

#### **OPTION 2: Eliminate regulations that act as barriers to using self-distribution authority.**

Potential Benefits: Could expand the use of self-distribution options, and thus may introduce additional market influence, and as a result could reduce price to consumers.

Potential Drawbacks: Could result in increased illegal or unreported sales if not accompanied by appropriate reporting and enforcement mechanisms.

#### **OPTION 3: Move toward complete elimination of mandated requirements to use traditional distribution tier.**

Potential Benefits: Allows market forces to drive the level of service provided in the distribution chain and could result in lower prices.

Potential Drawbacks: A more diffused system could make monitoring, enforcement and revenue collection difficult, and make it easier to sell or move product illegally.

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### Compelled Use of Distributors

#### APPENDIX A:

A relatively small portion of wine and beer sold in Washington is sold by in-state producers through direct sales (including both self-distribution to retailers and on-site direct sales to consumers).

- Approximately 8% of all wine sold in Washington in FY-06 was sold through direct sales (17% of all Washington-produced wine was sold through direct sales).
- Approximately 2% of all beer sold in Washington in FY-06 was sold through direct sales (36% of all Washington-produced beer was sold through direct sales.)

Wine Sales in gallons:						
	FY-01	FY-02	FY-03	FY-04	FY-05	FY-06
<b>WA DOMESTIC WINERIES</b>						
Self distributing/retail	971,192	1,424,607	2,629,599	2,688,984	1,303,506	1,720,690.00
WA Distributor	5,149,215	6,078,412	5,972,945	6,702,711	7,683,496	8,351,441
<b>Totals:</b>	<b>6,120,407</b>	<b>7,503,019</b>	<b>8,602,544</b>	<b>9,391,695</b>	<b>8,987,002</b>	<b>10,072,131</b>
<b>Percentage of Wine Self Distributed Compared to all WA Domestic Wineries Sales</b>	16%	19%	31%	29%	15%	17%
<b>Total Sales in Washington</b>	15,471,979	15,653,088	17,737,279	18,856,619	19,195,000	20,341,678
<b>Percentage of Wine Self Distributed Compared to all Sales in WA</b>	6%	9%	15%	14%	7%	8%
Beer Sales in Barrels:						
	FY-01	FY-02	FY-03	FY-04	FY-05	FY-06
<b>WA DOMESTIC BREWERIES</b>						
Self distributing/retail	47,012	80,656	77,660	73,093	76,460	79,315
WA Distributor	712,198	1,152,875	993,906	216,977	155,699	142,878
<b>Totals:</b>	<b>759,210</b>	<b>1,233,531</b>	<b>1,071,566</b>	<b>290,070</b>	<b>232,159</b>	<b>222,193</b>
<b>Percentage of Beer Self Distributed Compared to all WA Domestic Breweries Sales</b>	6%	7%	7%	25%	33%	36%
<b>Total Sales in Washington</b>	4,266,404	4,138,871	3,971,650	4,042,972	4,032,234	3,882,079
<b>Percentage of Beer Self Distributed Compared to all Sales in WA</b>	1%	2%	2%	2%	2%	2%

**Appendix I (4) – Issue Papers**  
**Tied House Laws – Ownership, Financial Interests and**  
**Money's Worth**

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Appendix I (4)  
\* \* \* Issue Paper Developed to Inform the Task Force \* \* \*  
**Policy Assessments, Impact Assessments and Potential Options were drafted to spark discussion and were not necessarily adopted or confirmed by the Task Force**  
**Tied House Laws – Ownership, Financial Interests and Money’s Worth**

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**EXECUTIVE SUMMARY**  
**RELATIONSHIP AMONG THE TIERS**  
**Tied House Laws: Money’s Worth and Ownership**

“Tied House” laws are intended to prevent inappropriate or coercive business practices among the various sectors of the liquor industry, either through domination of one tier over another or through exclusion of competitors’ products. **Washington’s cornerstone Tied House Statute, RCW 66.28.010(1)(a) addresses the two fundamental aspects of tied house laws:**

- The **prohibition against** manufacturers, importers, distributors and authorized representatives from owning or having a **financial interest in a retail license or owning property** on which a retailer operates; and
- The **prohibition against** manufacturers, importers, distributors and authorized representatives from **providing things of value** (“money or money’s worth”) to licensees.

**Washington’s approach to changes in the business and social climate since the 1930s has been to carve out discrete, targeted legislative exceptions** to these Tied House prohibitions as the need arises.

- Some industry members see this incremental approach to be a sound, conservative way to accommodate changes in the industry without compromising the foundational core of the Tied House statutes.
- Other industry members believe this approach has, over time, seriously eroded the foundation of the Tied House statute to the point where applying the statute and rules to actual business practices is impossibly convoluted and nearly unenforceable.
- Enforcement staff find the patchwork of exceptions difficult to explain and enforce.
- Public health and safety advocates fear that further loosening of the Tied House statutes – particularly as they relate to advertising – may have significant, negative consequences such as increased abusive consumption and underage drinking.
- And policymakers, facing an increasing numbers of requests for further exceptions, question whether it may be time for a more comprehensive set of revisions rather than continuing this piecemeal approach.

The impact of the state’s current Tied House statute, rules and multiple exceptions is wide ranging and can be difficult to summarize briefly because they span from what to some seems to be minutia, to issues involving national or international business interests, representing millions of dollars.

**While Washington has adopted a conservative, incremental approach to modifying the statutes, other models are provided by the Federal government and other states.** Unlike Washington’s regulations, the FAA Tied House regulations allow total ownership of a retailer, and allow partial ownership of a retailer provided there is no significant impact on competition. The FAA prohibits a number of activities that are also prohibited under Washington law (providing things of value to a retailer, paying for retailer advertising, for example) but **ONLY IF** the activity results in exclusion. Each state responding to the survey has adopted some form of tied house law that addresses both the ownership and money’s worth issues, but each state’s approach is unique with no single prevalent model.

**OWNERSHIP AND FINANCIAL INTEREST**

Washington’s Tied House statute prohibits suppliers (manufacturers, importers, distributors) from holding a financial interest in a retail licensee, from owning property on which a retailer is located; and from owning a

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### Tied House Laws – Ownership, Financial Interests and Money’s Worth

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retail license outright. The purpose of this prohibition has been to prevent the kind of practices that prompted Prohibition.

In the years since the Tied House statute was adopted, however, the business environment has changed dramatically and new forms of ownership and financial networks have emerged that were not contemplated in the 1930s. As a result, some types of business arrangements (and thus financial benefit) are prohibited today even in circumstances where the opportunity for domination or control over the retailer is remote or controllable through other means.

#### **MONEY OR MONEY’S WORTH: PROHIBITION AGAINST GIVING THINGS OF VALUE**

Money’s Worth issues are a concern because suppliers and retailers have difficulty understanding where the line is drawn between allowed and prohibited activities, and as important, why the line is drawn where it is.

From a retailer perspective it is difficult to understand the rationale behind the rules at times, and with the various exceptions that have been granted they can be difficult to apply.

#### **POTENTIAL OPTIONS**

**OPTION 1: No Change. Reaffirm the core principles of the Tied House statutes and limit or eliminate any opportunity for expansion of exemptions.**

**Potential Benefits:** It is the known approach and industry participants generally understand it, and those who do not understand can be provided training. Requiring all exemptions to be run through the Legislative process ensures only narrow exceptions will be allowed and therefore the system will change only incrementally if at all.

**Potential Drawbacks:** The current system does not provide a good fit for today’s business environment, and political solutions to economic and business regulation issues will likely increase. Enforcement becomes increasingly difficult if the tied house regulatory system is further eroded.

**OPTION 2: Relax current Tied House regulation and focus on regulating outcomes (such as monopolies, predatory sales practices or abusive consumption.)**

**Potential Benefits:** May provide a more flexible regulatory system that can more readily adapt to changes in the business and the public health and safety environments. Allows more potential for free market forces to come to play and therefore may result in benefits to the consumer.

**Potential Drawbacks:** Enforcement would likely be difficult, and would require additional state resources to monitor. Clearly defining unwanted outcomes would require a change in the way regulation is applied and enforced.

**OPTION 3: Give the LCB “de minimus” discretion, accompanied by some numerical criteria to allow overlapping financial interests (see the 1999 proposal). [Applies to Ownership component of the Tied House statute only.]**

**Potential Benefits:** Provides some flexibility for ownership arrangements that are more typical in today’s business and financial environments, while still maintaining LCB oversight and ability to deny licenses where undesirable outcomes may result.

**Potential Drawbacks:** May be a slippery slope, and without clear boundaries, may be difficult for the LCB to draw a bright line around what is “de minimus.” If financial interests become too blurred between the tiers, the end result could be a reemergence of the pre-prohibition tied house “evils.” Caution would be required and a set of clear measures put in place to monitor whether these potentially negative outcomes are emerging.

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#### **OPTION 4: Eliminate Tied House statutes altogether, and focus solely on outcomes.**

**Potential Benefits:** Would allow businesses to operate more efficiently and effectively. Focus on outcomes would eliminate some of the application of rules in ways that are perceived to be hyper technical or unreasonable, even if an undesirable outcome is not likely. More closely resembles the federal approach.

**Potential Drawbacks:** Would require more and different type of enforcement. The end result could be a reemergence of the pre-prohibition tied house “evils.” Caution would be required and a set of clear measures put in place to monitor whether these potentially negative outcomes are emerging.

**RELATIONSHIP AMONG THE TIERS**  
**Tied House Laws: Money’s Worth and Ownership**

**References:** RCW 66.28.010, 66.28.040; 66.28.042; 66.28.043; 66.28.150; 66.28.155; 66.28.190; 66.28.170; WAC 314-12-140, -145, -200, 314-13-020; 314-44-005, 314-52-040, 314-52-080, 314-52-085, 314-52-090, 314-52-113

**ISSUE STATEMENT:**

*Washington’s Tied House statute, which is meant to prevent inappropriate or coercive business practices among the various sectors of the liquor industry, has been modified over the past several decades.*

- *Some industry members see this incremental approach to be a sound, conservative way to accommodate changes in the industry without compromising the foundational core of the Tied House statutes.*
- *Other industry members believe this approach has, over time, seriously eroded the foundation of the Tied House statute to the point where applying the statute and rules to actual business practices is impossibly convoluted and nearly unenforceable.*
- *Enforcement staff find the patchwork of exceptions difficult to explain and enforce.*
- *Public health and safety advocates fear that further loosening of the Tied House statutes – particularly as they relate to advertising – may have significant, negative consequences such as increased abusive consumption and underage drinking.*
- *And policymakers, facing an increasing numbers of requests for further exceptions, question whether it may be time for a more comprehensive set of revisions rather than continuing this piecemeal approach.*

*Ever-growing demand for additional legislative exceptions to the Tied House statutes have prompted the LCB and the Legislature to consider whether the state’s previous incremental approach to modification continues to be the best course of action, given the dramatic changes in the business and social climate in the past several decades.*

**BACKGROUND:**

**“Tied House” laws refer to statutes and rules adopted by virtually every state, and at the federal level, to regulate how alcoholic beverages are marketed and how the various tiers of the industry interact.** These laws are designed to prevent inappropriate or coercive business practices among the various sectors of the liquor industry, either through domination of one tier over another or through exclusion of competitors’ products.

As has been discussed in previous task force meetings, before Prohibition, it had become common practice for alcohol retailers to be closely controlled by large distillers and brewers, in effect to become “tied” to the more economically powerful suppliers. Control took the form of leases, chattel mortgages, credit and other financial interests. This control by the supplier level forced retailers to adopt programs to promote consumption and increased sales. These tied-houses sponsored activities fostered levels of beverage alcohol consumption that offended the moral and social values of many of the communities in which they were located. In other words, the suppliers’ hands-on

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involvement in the retailing of alcohol created financial incentives to increase alcohol sales to levels that were perceived to be excessive and detrimental to both consumers and society as a whole.<sup>1</sup>

Washington’s cornerstone Tied House Statute, RCW 66.28.010(1)(a) addresses the two fundamental aspects of tied house laws:

- ✓ **The prohibition against manufacturers, importers, distributors and authorized representatives from owning or having a financial interest in a retail license or owning property on which a retailer operates; and**
- ✓ **The prohibition against manufacturers, importers, distributors and authorized representatives from providing things of value (“money or money’s worth”) to licensees.**

The full text of the statute is provided in Appendix A. The statute is supported by an array of agency-adopted rules that address specific types of restrictions or prohibitions.

The Tied House Statute was part of Washington’s initial alcohol beverage distribution scheme adopted in the 1930s. Since that time the business and consumer environment has changed dramatically. For example:

- Highly complex, diversified ownership arrangements have developed that were never contemplated in the 1930s.
- Business transactions occur in a globalized marketplace beyond state geographical jurisdiction. (This raises difficult questions related to the state’s policy goals. For example, for tax purposes, where does the transaction occur? Taxation has always occurred at the point of sale...where is the point of sale? When does the transaction occur?)
- Retail outlets have become significantly more diverse. Outlets have expanded from the traditional saloon or tavern to now include brew pubs, restaurants, stadiums, hotels, theme parks, private clubs, big box stores, convenience stores, etc.
- Manufacturers have multiplied into a diverse array of mostly small wineries and breweries, creating a highly competitive market and broad choice of product. And as the number of manufacturers has increased, the volume of product available has increased as well.
- Consumers have become more sophisticated, demanding and accustomed to diverse selection;
- The power of the supplier has been matched by the power of mega-retailers.

**Washington’s approach to these changes has been to carve out discrete, targeted legislative exceptions as the need arises.** Numerous exceptions have been granted since the 1930s. For example, Bass PLC (Public Limited Company) owns both Bass Hotels (including the Holiday Inn hotel chain) and Bass Ale. Holiday Inns wanted to be able to hold a license to sell alcohol on their premises, but because Bass Ale is a manufacturer the state was unable to issue a retail license. The legislature adopted a narrowly drawn exception to allow a corporation to have an ownership interest

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<sup>1</sup> *Alcohol Distribution Laws Bottle Up Options for Consumers and Retailers*, Morgan Smith, Georgia Public Policy Foundation (October 16, 2002).

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in both a brewery and a retail license, under limited circumstances.<sup>2</sup> (A list of many of the exceptions is included in Appendix B.)

- Some industry members see this incremental approach to be a sound, conservative way to accommodate changes in the industry without compromising the foundational core of the Tied House statutes.
- Other industry members believe this approach has, over time, seriously eroded the foundation of the Tied House statute to the point where applying the statute and rules to actual business practices is impossibly convoluted and nearly unenforceable.
- Enforcement staff find the patchwork of exceptions difficult to explain and enforce.
- Public health and safety advocates fear that further loosening of the Tied House statutes – particularly as they relate to advertising – may have significant, negative consequences such as increased abusive consumption and underage drinking.
- And policymakers, facing an increasing numbers of requests for further exceptions, question whether it may be time for a more comprehensive set of revisions rather than continuing this piecemeal approach.

**The impact of the state’s current Tied House statute, rules and multiple exceptions is wide ranging and can be difficult to summarize briefly because they span from what to some seems to be minutia, to issues involving national or international business interests, representing millions of dollars.** Advertising restrictions, for example, that flow from the prohibition against providing a retailer “money or money’s worth” can get hyper-technical. For example, a retailer may be allowed to display a neon light provided by a supplier UNLESS the neon light provides ambient light in which case it is allowing the retailer to use less of its own lighting and therefore becomes a “thing of value” to the retailer (in which case it is prohibited). On the other hand, advertising restrictions also currently prohibit Sports and Entertainment Facilities from entering into multimillion dollar deals for “naming rights” of sports fields or clubs located within the sport or entertainment venue. See “Scenario 1 – Naming Rights” for a more detailed discussion of this issue, including industry and public health and safety perspectives on this form of advertising.

## OTHER MODELS

Washington is not alone in dealing with the growing complexity of tied house issues. While Washington has adopted a conservative, incremental approach to modifying the statutes, other models are provided by the Federal government and other states. Each state responding to the survey has adopted some form of tied house law that addresses both the ownership and money’s worth issues, but each state’s approach is unique with no single prevalent model.

### Federal Alcohol Administration Act (FAA):

The Federal government also regulates the relationships between and among suppliers and retailers, through the Federal Alcohol Administration Act (FAA). The FAA includes provisions to preclude unfair trade practices, similar to Washington’s Tied House statute. These provisions regulate practices such as exclusive outlets (an exclusive outlet is a practice by which a supplier *requires* a

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<sup>2</sup> The exemption is available, provided the corporate entity does not influence its related business activities or offers for sale any liquor products that are produced or distributed by a subsidiary.

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retailer to purchase its alcohol beverages) and tied house arrangements (a practice whereby a supplier *induces* a retailer to purchase its alcohol beverages).

Unlike Washington’s regulations, the FAA Tied House regulations allow total ownership of a retailer, and allow partial ownership of a retailer provided there is no significant impact on competition. The FAA prohibits a number of activities that are also prohibited under Washington law (providing things of value to a retailer, paying for retailer advertising, for example) but **ONLY IF** the activity results in exclusion. Exclusion means that a practice:

- Must **place a retailer’s independence at risk** by means of a tie or link between the supplier and the retailer; AND,
- That such practice results in the **retailer purchasing less that it would have of a competitor’s product.**

A key distinction between the FAA and Washington’s Tied House statutes is that proving a violation of the FAA is difficult because violations under the FAA require proving the practice resulted in exclusion. Proving this can be very difficult (particularly proving the practice resulted in an impact on the retailer’s purchasing.)

### OWNERSHIP AND FINANCIAL INTEREST

Washington’s Tied House statute prohibits suppliers (manufacturers, importers, distributors and authorized representatives) from holding a financial interest in a retail licensee, from owning property on which a retailer is located; and from owning a retail license outright. (Exceptions to this strict prohibition have been granted and are discussed below.) The purpose of this prohibition has been to prevent the kind of practices that prompted Prohibition.

In the years since the Tied House statute was adopted, however, the business environment has changed dramatically and new forms of ownership and financial networks have emerged that were not contemplated in the 1930s. As a result, **some types of business arrangements (and thus financial benefit) are prohibited today even in circumstances where the opportunity for domination or control over the retailer is considered by some to be remote or controllable through other means.** During stakeholder interviews, one stakeholder described a circumstance when a retail license had been denied because one of the financial backers was a national insurance company and one of the insurance company’s board of directors held an interest in an out-of-state winery. The Bass Ale exception is an example of where the legislature incorporated safeguards into the statute to significantly reduce the opportunity for unwanted behavior to occur (or if it does occur, jeopardizes the retail license). That exception allows the overlapping ownership.

One of the most prominent issues related to this Tied House restriction in Washington today is the impact on sports and entertainment facilities. These entities would like to be able to sell the “naming” rights for a sports and/or entertainment facility (or a club located within such a facility) to an alcohol beverage manufacturer. This practice is allowed in some other states (see, for example, Coors Field in Colorado, and the Miller Club/Bud Zone at the Iowa Events Center.) Scenario 1 describes this issue in more detail.

In 1999, the LCB convened a review panel to consider changes to the three-tier system, including Tied House statute’s prohibition against overlapping financial interests among the tiers. That review panel considered two approaches to this issue that are used in other states. The first alternative

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proposed by the review panel would permit “de minimus” overlapping ownership interest, in which the arrangement would be permitted with certain safeguards in place (similar to the approach used with Bass Ale.) The second approach allows a certain numerical criteria for overlapping ownership – for example, up to 5% of stock ownership could be allowed, or no more than 10% of the product sold by the retailer in question could be from the interested manufacturer. A summary of alternative tied house laws considered by the 1999 review panel is provided as a separate handout.

#### **MONEY OR MONEY’S WORTH: PROHIBITION AGAINST GIVING THINGS OF VALUE**

**Money’s Worth issues are a concern because suppliers and retailers have difficulty understanding where the line is drawn between allowed and prohibited activities, and as important, why the line is drawn where it is.** For example, a retailer hosting a wine tasting showcasing a particular winery may ask the wine maker to be present and to provide education both to the retailer’s staff and to consumers about the particular wine. The winery may also provide a small amount of product for sampling. The winemaker, however, is NOT allowed to help pour the wine being sampled (that would free up the retailer’s staff for other duties and thus be considered giving the retailer “value”). See “Scenario 2 – Money’s Worth and the Wine Industry” for additional examples of this issue and the perspectives on providing value to retailers.

**From a retailer perspective it is difficult to understand the rationale behind the rules at times, and with the various exceptions that have been granted they can be difficult to apply.** The purpose of these rules is to ensure that suppliers cannot control, through economic inducement, the actions of the retailer. It is difficult for industry participants to understand how accepting matchbooks or coasters from a supplier can reasonably be expected to translate into that type of control. From an enforcement standpoint, the coasters represent a slippery slope. While one box may not represent an inducement, one hundred thousand may. And, with the exceptions that have been granted, the once bright line between accepted and prohibited practices has become somewhat blurred.

Common Tied House examples that the LCB enforcement officers have had to say “no” to that manufacturers or retailers do not always understand:

- Wineries want to take their product on the road and sell to hotels/restaurants beyond their licensed location(s). This is a violation of their license that allows them to sell at retail from their licensed locations only.
- Manufacturer wants to be able to give product away for sampling, as part of their marketing strategy. For example, if a Specialty Wine Shop purchases three cases, the manufacturer may want to give them a case for free for wine tastings or to give to customers as samples.
- Breweries want to enter into agreements with retailers to provide sponsorships, rebates, or contests at the retail establishment. For example, Restaurant A wants to have a basketball hoop shoot contest and offer a \$10,000 prize to bring customers in. Instead of having \$10,000 cash on hand in case someone wins, a third-party agent may be willing to take a \$1,000 bond and take the risk that the shooter will actually make the shot. A manufacturer supplying beer to Restaurant A may want to pay the \$1,000 to the third party assuming that does not violate the Tied House rules. However, it provides value to the retailer since the retailer would no longer have to put up the \$1,000 itself. Therefore it is a violation.

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- Advertising wine tastings at restaurants. A winery may want to advertise if a local retailer is featuring the winery’s product at a wine dinner. This provides free advertising for the retailer and would be prohibited.
  - The winery can be at the wine dinner and provide education to those attending, but may not pour the product, nor may they take orders at the event.
  - A winery may also list on their website the retailers that carry their product, but may NOT put a hotlink to that retailer’s website on the winery’s web site.

#### **ENFORCEMENT OF TIED HOUSE STATUTES:**

The LCB has five enforcement officers dedicated to the enforcement of Tied House laws and rules, and other issues related specifically to Manufacturers, Importers and Wholesalers (Distributors). These five agents are responsible for monitoring and enforcing these rules across all three tiers, including approximately 1,900 in-state and out-of-state manufacturers, COAs, authorized representatives, and foreign importers, 150 distributors, and 12,000 retailers.

#### **CURRENT REGULATIONS’ CONTRIBUTION TO STATE’S POLICY GOALS:**

1. **Does the state’s current Tied House statutes and rules contribute to the state’s policy goal of preventing the misuse of alcohol? If yes, how?**

Yes, strict adherence to the Tied House statutes, and allowing only narrowly drawn exceptions through the legislative process, continues to restrict the availability of alcohol, limits beer and wine advertising opportunities and constrains the impact of social norming that may contribute to increased abusive consumption. In addition, the Tied House statutes have set distinct boundaries that tend to constrain illegal activities. (As an analogy, if the speed limit is 60 MPH, a person may be willing to drive at a slightly higher speed – say 70 – even if it is not legal, but they are far less likely to drive at 90 MHP.)

2. **Does the state’s current Tied House statutes and rules contribute to the state’s policy goal of efficient collection of taxes? If yes, how?**

Does not contribute to or detract from the state’s goal of efficient collection of taxes.

3. **Does the state’s current Tied House statutes and rules promote the public interest in fostering the orderly and responsible distribution of malt beverages and wine towards effective control of consumption? If yes, how?**

Yes, the Tied House prohibition against overlapping ownership interests across the tiers contributes to keeping the supplier roles (manufacturer, importer, and distributor) separate and distinct from the role of the retail tier, and helps to keep suppliers from exerting undue influence on the retail tier to exclude competitor’s products from the marketplace.

#### **CURRENT SYSTEM IMPACT ASSESSMENT:**

*Note: This impact assessment is offered to stimulate productive discussion and is based on feedback received from industry participants, a brief review of relevant materials and research literature. It is not intended to provide an exhaustive assessment of all potential impacts. The impacts identified have not be thoroughly tested or evaluated.*

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The following assessment reflects the impacts of the current Tied House system of regulation as opposed to no regulation of ownership interests or providing items of value to retailers. It does not compare the current system to alternative systems of control or regulation, such as increased emphasis on controlling for outcomes such as overserving or underage drinking.

CONSUMER	BUSINESS	STATE	SOCIETY
<i>(price, convenience, selection)</i>	<i>(costs, unnecessary market restrictions, revenues, private employment)</i>	<i>(state resources, state sales and tax revenues, state employment)</i>	<i>(alcohol misuse, youth access to alcohol, environmental pressures encouraging misuse)</i>
Maintains higher prices because free market influences are diminished by the various prohibitions. According to many industry participants, these restrictions also serve to maintain product diversity by prohibiting practices designed to exclude competitor’s products.	Restricts free market influences by prohibiting some firms from entering into financial and ownership arrangements that may otherwise have positive economic results for the firm (and in some cases, such as public stadiums, some would argue positive economic results for the community.) Reduces industry participants’ ability to conduct marketing and advertising that in other industries may be acceptable.	A small number of state employees are devoted to monitoring and enforcing trade practices that could otherwise be assigned to monitoring and enforcing outcome-based activities (e.g., overserving and serving underage drinkers). Some sales tax revenues might be lost because sales are lower with the money’s worth provisions in place, but this is likely off-set by the fewer state resources devoted to enforcing and treating abusive consumption.	Prohibiting overlapping financial interests and ownership, and limiting opportunities for providing inducements to purchase a manufacturer’s product help prevent the type of domination and coercion seen pre-prohibition. Limiting marketing and advertising practices reduces the potential for overserving, and underage drinking.

### POLICY OPTIONS FOR CONSIDERATION:

*NOTE: These options are offered to stimulate discussion. **They are not necessarily the best or only alternatives available.** The analysis of potential benefits and drawbacks represents our best efforts at assessing impacts based on feedback received from industry members, and a brief review of relevant literature. They have not been thoroughly tested or evaluated.*

	Consumers	Business	State	Society
Option 1	NC	NC	NC	NC
Option 2	NC	+	--	--
Option 3	+	+	--	--
Option 4	+	+	--	--

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#### **OPTION 1: No Change. Reaffirm the core principles of the Tied House statutes and limit or eliminate any opportunity for expansion of exemptions.**

Potential Benefits: It is the known approach and industry participants generally understand it, and those who do not understand can be provided training. Requiring all exemptions to be run through the Legislative process ensures only narrow exceptions will be allowed and therefore the system will change only incrementally if at all.

Potential Drawbacks: The current system does not provide a good fit for today's business environment, and political solutions to economic and business regulation issues will likely increase. Enforcement becomes increasingly difficult if the tied house regulatory system is further eroded.

#### **OPTION 2: Relax current Tied House regulation and focus on regulating outcomes (such as monopolies, predatory sales practices or abusive consumption.)**

Potential Benefits: May provide a more flexible regulatory system that can more readily adapt to changes in the business and the public health and safety environments. Allows more potential for free market forces to come to play and therefore may result in benefits to the consumer.

Potential Drawbacks: Enforcement would likely be difficult, and would require additional state resources to monitor. Clearly defining unwanted outcomes would require a change in the way regulation is applied and enforced.

#### **OPTION 3: Give the LCB “de minimus” discretion, accompanied by some numerical criteria to allow overlapping financial interests (see the 1999 proposal). [Applies to Ownership component of the Tied House statute only.]**

Potential Benefits: Provides some flexibility for ownership arrangements that are more typical in today's business and financial environments, while still maintaining LCB oversight and ability to deny licenses where undesirable outcomes may result.

Potential Drawbacks: May be a slippery slope, and without clear boundaries, may be difficult for the LCB to draw a bright line around what is “de minimus.” If financial interests become too blurred between the tiers, the end result could be a reemergence of the pre-prohibition tied house “evils.” Caution would be required and a set of clear measures put in place to monitor whether these potentially negative outcomes are emerging.

#### **OPTION 4: Eliminate Tied House statutes altogether, and focus solely on outcomes.**

Potential Benefits: Would allow businesses to operate more efficiently and effectively. Focus on outcomes would eliminate some of the application of rules in ways that are perceived to be hyper technical or unreasonable, even if an undesirable outcome is not likely. More closely resembles the federal approach.

Potential Drawbacks: Would require more and different type of enforcement. The end result could be a reemergence of the pre-prohibition tied house “evils.” Caution would be required and a set of clear measures put in place to monitor whether these potentially negative outcomes are emerging.

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#### APPENDIX A: RCW 66.28.010

##### **Manufacturers, importers, distributors, and authorized representatives barred from interest in retail business or location — Advances prohibited — "Financial interest" defined — Exceptions.**

(1)(a) No manufacturer, importer, distributor, or authorized representative, or person financially interested, directly or indirectly, in such business; whether resident or nonresident, shall have any financial interest, direct or indirect, in any licensed retail business, unless the retail business is owned by a corporation in which a manufacturer or importer has no direct stock ownership and there are no interlocking officers and directors, the retail license is held by a corporation that is not owned directly or indirectly by a manufacturer or importer, the sales of liquor are incidental to the primary activity of operating the property as a hotel, alcoholic beverages produced by the manufacturer or importer or their subsidiaries are not sold at the licensed premises, and the board reviews the ownership and proposed method of operation of all involved entities and determines that there will not be an unacceptable level of control or undue influence over the operation or the retail licensee; nor shall any manufacturer, importer, distributor, or authorized representative own any of the property upon which such licensed persons conduct their business; nor shall any such licensed person, under any arrangement whatsoever, conduct his or her business upon property in which any manufacturer, importer, distributor, or authorized representative has any interest unless title to that property is owned by a corporation in which a manufacturer has no direct stock ownership and there are no interlocking officers or directors, the retail license is held by a corporation that is not owned directly or indirectly by the manufacturer, the sales of liquor are incidental to the primary activity of operating the property either as a hotel or as an amphitheater offering live musical and similar live entertainment activities to the public, alcoholic beverages produced by the manufacturer or any of its subsidiaries are not sold at the licensed premises, and the board reviews the ownership and proposed method of operation of all involved entities and determines that there will not be an unacceptable level of control or undue influence over the operation of the retail licensee. Except as provided in subsection (3) of this section, no manufacturer, importer, distributor, or authorized representative shall advance moneys or moneys' worth to a licensed person under an arrangement, nor shall such licensed person receive, under an arrangement, an advance of moneys or moneys' worth. "Person" as used in this section only shall not include those state or federally chartered banks, state or federally chartered savings and loan associations, state or federally chartered mutual savings banks, or institutional investors which are not controlled directly or indirectly by a manufacturer, importer, distributor, or authorized representative as long as the bank, savings and loan association, or institutional investor does not influence or attempt to influence the purchasing practices of the retailer with respect to alcoholic beverages. Except as otherwise provided in this section, no manufacturer, importer, distributor, or authorized representative shall be eligible to receive or hold a retail license under this title, nor shall such manufacturer, importer, distributor, or authorized representative sell at retail any liquor as herein defined. A corporation granted an exemption under this subsection may use debt instruments issued in connection with financing construction or operations of its facilities.

(b) Nothing in this section shall prohibit a licensed domestic brewery or microbrewery from being licensed as a retailer pursuant to chapter [66.24](#) RCW for the purpose of selling beer or wine at retail on the brewery premises and nothing in this section shall prohibit a domestic winery from being licensed as a retailer pursuant to chapter [66.24](#) RCW for the purpose of selling beer or wine at retail on the winery premises. Such beer and wine so sold at retail shall be subject to the taxes imposed by RCW [66.24.290](#) and [66.24.210](#) and to reporting and bonding requirements as prescribed by regulations adopted by the board pursuant to chapter [34.05](#) RCW, and beer and wine that is not produced by the brewery or winery shall be purchased from a licensed beer or wine distributor.

(c) Nothing in this section shall prohibit a licensed distiller, domestic brewery, microbrewery, domestic winery, or a lessee of a licensed domestic brewer, microbrewery, or domestic winery, from being licensed as a spirits, beer, and wine restaurant pursuant to chapter [66.24](#) RCW for the purpose of selling liquor at a spirits, beer, and wine restaurant premises on the property on which the primary manufacturing facility of the licensed distiller, domestic brewer, microbrewery, or domestic winery is located or on contiguous property owned or leased by the licensed distiller, domestic brewer, microbrewery, or domestic winery as prescribed by rules adopted by the board pursuant to chapter [34.05](#) RCW.

(d) Nothing in this section prohibits retail licensees with a caterer's endorsement issued under RCW [66.24.320](#) or [66.24.420](#) from operating on a domestic winery premises.

(e) Nothing in this section prohibits an organization qualifying under RCW [66.24.375](#) formed for the purpose of constructing and operating a facility to promote Washington wines from holding retail licenses on the facility property or leasing all or any portion of such facility property to a retail licensee on the facility property if the members of the board of directors or officers of the board for the organization include officers, directors, owners, or employees of a licensed domestic winery. Financing for the construction of the facility must include both public and private money.

(f) Nothing in this section prohibits a bona fide charitable nonprofit society or association registered as a 501(c)(3) under the internal revenue code and having an officer, director, owner, or employee of a licensed domestic winery or a wine certificate of approval holder on its board of directors from holding a special occasion license under RCW [66.24.380](#).

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(g) Nothing in this section prohibits domestic wineries and retailers licensed under chapter [66.24](#) RCW from jointly producing brochures and materials promoting tourism in Washington state which contain information regarding retail licensees, domestic wineries, and their products.

(h) Nothing in this section prohibits domestic wineries and retail licensees from identifying the wineries on private labels authorized under RCW [66.24.400](#), [66.24.425](#), and [66.24.450](#).

(i) Until July 1, 2007, nothing in this section prohibits a nonprofit statewide organization of microbreweries formed for the purpose of promoting Washington's craft beer industry as a trade association registered as a 501(c) with the internal revenue service from holding a special occasion license to conduct up to six beer festivals.

(2) Financial interest, direct or indirect, as used in this section, shall include any interest, whether by stock ownership, mortgage, lien, or through interlocking directors, or otherwise. Pursuant to rules promulgated by the board in accordance with chapter [34.05](#) RCW manufacturers, distributors, and importers may perform, and retailers may accept the service of building, rotating and restocking case displays and stock room inventories; rotating and rearranging can and bottle displays of their own products; provide point of sale material and brand signs; price case goods of their own brands; and perform such similar normal business services as the board may by regulation prescribe.

(3)(a) This section does not prohibit a manufacturer, importer, or distributor from providing services to a special occasion licensee for: (i) Installation of draft beer dispensing equipment or advertising, (ii) advertising, pouring, or dispensing of beer or wine at a beer or wine tasting exhibition or judging event, or (iii) a special occasion licensee from receiving any such services as may be provided by a manufacturer, importer, or distributor. Nothing in this section shall prohibit a retail licensee, or any person financially interested, directly or indirectly, in such a retail licensee from having a financial interest, direct or indirect, in a business which provides, for a compensation commensurate in value to the services provided, bottling, canning or other services to a manufacturer, so long as the retail licensee or person interested therein has no direct financial interest in or control of said manufacturer.

(b) A person holding contractual rights to payment from selling a liquor distributor's business and transferring the license shall not be deemed to have a financial interest under this section if the person (i) lacks any ownership in or control of the distributor, (ii) is not employed by the distributor, and (iii) does not influence or attempt to influence liquor purchases by retail liquor licensees from the distributor.

(c) The board shall adopt such rules as are deemed necessary to carry out the purposes and provisions of subsection (3)(a) of this section in accordance with the administrative procedure act, chapter [34.05](#) RCW.

(4) A license issued under RCW [66.24.395](#) does not constitute a retail license for the purposes of this section.

(5) A public house license issued under RCW [66.24.580](#) does not violate the provisions of this section as to a retailer having an interest directly or indirectly in a liquor-licensed manufacturer.

[2006 c 330 § 28; 2006 c 92 § 1; 2006 c 43 § 1. Prior: 2004 c 160 § 9; 2004 c 62 § 1; 2002 c 109 § 1; 2000 c 177 § 1; prior: 1998 c 127 § 1; 1998 c 126 § 11; 1997 c 321 § 46; prior: 1996 c 224 § 3; 1996 c 106 § 1; 1994 c 63 § 1; 1992 c 78 § 1; 1985 c 363 § 1; 1982 c 85 § 7; 1977 ex.s. c 219 § 2; 1975-76 2nd ex.s. c 74 § 3; 1975 1st ex.s. c 173 § 6; 1937 c 217 § 6; 1935 c 174 § 14; 1933 ex.s. c 62 § 90; RRS § 7306-90; prior: 1909 c 84 § 1.]

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### Tied House Laws – Ownership, Financial Interests and Money’s Worth

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#### APPENDIX B: EXCEPTIONS TO THE TIED HOUSE STATUTE (not exhaustive)

GENERAL RULE	
Prohibition against Manufacturer (M), Importer (I), Distributor (D) or Authorized Representative (AR) having a financial interest, direct or indirect, in a retailer’s business or property on which the business is conducted.  Prohibition against M, I, D, AR holding a retail license.	Prohibition against Manufacturer (M), Importer (I), Distributor (D) or Authorized Representative (AR) providing money or money’s worth to a licensed retailer
EXCEPTIONS	
1930s: Breweries and Wineries authorized to distribute their own product to retailers.	1935: Allows M, I, D to furnish free samples of liquor to LCB to promote a sale.
1975: In-state wineries and breweries are allowed retail sales of their own products at their winery or brewery.	1933/1969: Allows M to give free samples at brewery/winery.
1975: Allows beer M to add retail license to sell beer other than its own production at brewery location.	1975: Allows M, I, D to build or restock, displays and inventories for the retailer and to rearrange displays of its own products.
1977: In-state wineries and breweries allowed to own a spirits, beer and wine restaurant on winery or brewery property.	1975: Allows M, I, D to provide point of sale materials and brand signs to retailer.
1982. Retailers allowed to have an interest in a business that provides bottling or canning services to a manufacturer.	1975: Allows M, I, D to provide “normal business services” approved by the board to a retailer.
1985: D who sells its business and becomes a retailer is allowed to receive payments from the sale under a real estate contract.	1981: Allows M, I, D to furnish free samples to retailers to promote a sale.
1985: A Common Carrier license (allowing a common carrier to retail alcohol to passengers) is not considered a retail license. (Add for a M that wanted to purchase a cruise line)	1982: Exempts banks and investors of the retailer as long as no influence is exerted over purchasing decisions of the retailer.
1996 (amended 1998): M allowed to have an indirect interest in property on which a retail liquor licensee does business and which is used for outdoor entertainment.	1982: Allows M, I, D to provide to special occasion retailer, beer tapping equipment or advertising.
1998: A corporation allowed under certain circumstances to have an interest in both a licensed retailer and a licensed M.	1982: Allows M, I, D to provide non-profit special occasion retail licensees advertising and pouring of beer/wine at wine tasting event.

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2000: In-state M allowed to have up to two off-site retail sales locations.	1988: Allows beer and wine D to sell non-liquor food products to retailers on 30-day credit.
2001: Licensed restaurants and private clubs may sell private label Washington wines “to go.”	1990: Allows M, I, D to provide tickets to athletic events and other entertainment and provide food and beverages at the event to a retailer.
2002: Allows in-state M or retailer to operate a spirits restaurant on property owned or leased by an in-state M.	1990: Allows M, I, D to provide food and beverage to retailer at business meeting.
2003: In-state Ms allowed to sell their bottled wine at farmers markets.	2006: Allows identification of winery on front of private labels.
2004: Allows a caterer to hold a retail license and operate at a winery.	2006: Allows joint promotion of Ms and retailers on tourism brochures.
2006: Allows construction of a wine promotion facility.	

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**APPENDIX C: Federal Alcohol Administration Act**

**27 United States Code, Chapter 8, Subchapter I, Section 205**

**(a) Exclusive outlet**

[It shall be unlawful ...] To require, by agreement or otherwise, that any retailer engaged in the sale of distilled spirits, wine, or malt beverages, purchase any such products from such person to the exclusion in whole or in part of distilled spirits, wine, or malt beverages sold or offered for sale by other persons in interstate or foreign commerce, if such requirement is made in the course of interstate or foreign commerce, or if such person engages in such practice to such an extent as substantially to restrain or prevent transactions in interstate or foreign commerce in any such products, or if the direct effect of such requirement is to prevent, deter, hinder, or restrict other persons from selling or offering for sale any such products to such retailer in interstate or foreign commerce

**(b) “Tied house”**

[It shall be unlawful ...] To induce through any of the following means, any retailer, engaged in the sale of distilled spirits, wine, or malt beverages, to purchase any such products from such person to the exclusion in whole or in part of distilled spirits, wine, or malt beverages sold or offered for sale by other persons in interstate or foreign commerce, if such inducement is made in the course of interstate or foreign commerce, or if such person engages in the practice of using such means, or any of them, to such an extent as substantially to restrain or prevent transactions in interstate or foreign commerce in any such products, or if the direct effect of such inducement is to prevent, deter, hinder, or restrict other persons from selling or offering for sale any such products to such retailer in interstate or foreign commerce: (1) By acquiring or holding (after the expiration of any existing license) any interest in any license with respect to the premises of the retailer; or (2) by acquiring any interest in real or personal property owned, occupied, or used by the retailer in the conduct of his business; or (3) by furnishing, giving, renting, lending, or selling to the retailer, any equipment, fixtures, signs, supplies, money, services, or other thing of value, subject to such exceptions as the Secretary of the Treasury shall by regulation prescribe, having due regard for public health, the quantity and value of articles involved, established trade customs not contrary to the public interest and the purposes of this subsection; or (4) by paying or crediting the retailer for any advertising, display, or distribution service; or (5) by guaranteeing any loan or the repayment of any financial obligation of the retailer; or (6) by extending to the retailer credit for a period in excess of the credit period usual and customary to the industry for the particular class of transactions, as ascertained by the Secretary of the Treasury and prescribed by regulations by him; or (7) by requiring the retailer to take and dispose of a certain quota of any of such products.

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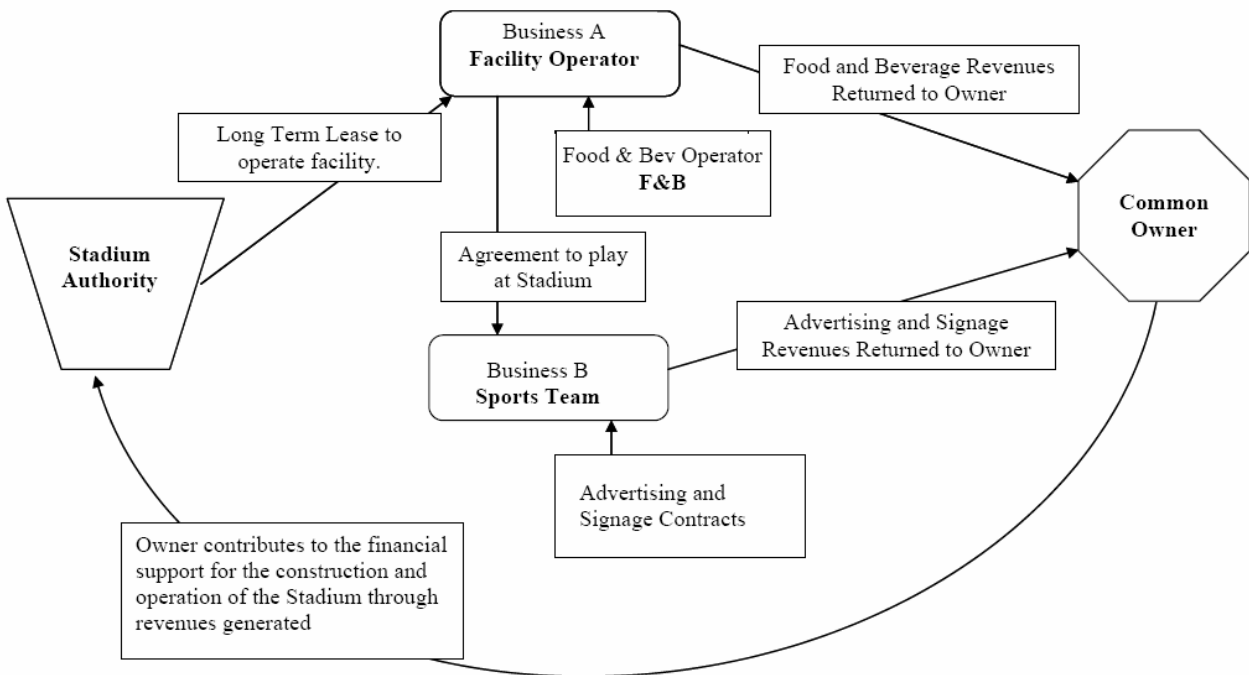
\*\*\* Issue Paper Developed to Inform the Task Force \*\*\*

Policy Assessments, Impact Assessments and Potential Options were drafted to spark discussion and were not necessarily adopted or confirmed by the Task Force  
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### SCENARIO 1: NAMING RIGHTS

The following scenario is intended to generate discussion about Tied House laws and rules as they relate to the issue of naming rights at sports and entertainment facilities. The legal organization described in the scenario is used for illustrative purposes only and is not intended to represent all the various legal organizations, entity relationships and contractual agreements employed by sports and entertainment facilities. Each permutation brings with it a unique set of issues associated with Tied House restrictions related to naming rights. For Task Force discussion purposes, we provide a single scenario that highlights some of the complexities embedded in this issue.



#### SCENARIO:

- Stadium is owned by a public stadium authority (“Stadium Authority”).
- Stadium Authority enters into a long-term lease with a private entity, Business A (“Operator”), to operate the facility 12 months a year.
- Operator enters into an agreement with a food and beverage firm (“F&B”) to run the concessions operations. That agreement provides that Operator will receive \$.25 for every \$1 of food or beverage sold on-premise. The profit from these agreements goes back to Operator’s parent company (“Common Owner”).

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- F&B obtains a “Sports and Entertainment Facility” liquor license to serve beer and wine on-premises.
  - Operator is a party in interest on the license because it has a financial interest in the license.
- Operator also enters into a written agreement with Business B (“Sports Team”) to play at the facility during their regular season.
  - Operator and Sports Team are owned by the same parent company, “Common Owner”.
- Sports Team generates operating revenue, in part, by entering into advertising agreements with other businesses (including beer / wine manufacturers). These agreements allow the advertiser to provide signage (banners, for example) and other forms of advertising to be placed around the stadium when the team is playing. The advertisers want the exposure and want consumers to associate their name with the sports team, and in return the sports team receives compensation. The profit from these agreements goes back to Sports Team’s parent company, Common Owner.

#### **THE REQUEST:**

- To increase revenues, Sports Team wants to enter into an agreement with a national beer manufacturer, Geoduck Brewing, to name a club on the Stadium premises. Under the agreement, the club would be called the Geoduck Club, and the club would have a Geoduck theme – servers would wear Geoduck T-shirts, coasters would be stamped with their logo. However, the service within the club would continue to be provided by F&B, and F&B will continue to have complete discretion over what is poured in the Club.
  - In no case will the Geoduck be exclusively sold at the club.

#### **DENIED BECAUSE OF TIED HOUSE STATUTES AND RULES:**

- The LCB prohibits the agreement as a violation of the Tied House statutes – Operator is a “party in interest” in F&B’s sports and entertainment liquor license and Operator returns their profits from the F&B contract to Common Owner. Operator and Sports Team are both owned by Common Owner. Therefore, Common Owner (and by extension their subsidiary company Sports Team) has a financial interest in the retail liquor license.
- The Tied House law, prohibits a retail licensee from entering into these types of advertising agreements, because such agreements may create undue pressure to serve primarily or exclusively the product of the naming entity (in this case Geoduck).

#### **SPORTS AND ENTERTAINMENT FACILITY OPERATORS PERSPECTIVE:**

- Sports and Entertainment Facilities are a new type of facility not contemplated in 1930s when the Tied House statute was first put in place. And they are unique in today’s environment as well. Because these facilities are structured so differently, attempting to regulate advertising and sponsorship relationships by defining who can have them and who cannot does not work. It only serves to create inequities among facilities, based simply on the legal structure chosen by the organizations involved in the facility.
- Unlike restaurants, they are in the business of operating a sports facility. Food and beverage is ancillary to the operation, not a core business function. Having a financial interest in the liquor

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license should not preclude the operator from entering into advertising and sponsorship agreement with manufacturers of beer and wine because the businesses are different.

- The food and beverage operator would continue to maintain its independence and it’s in that firm’s own best interest to offer a wide array of products that consumers will buy. And, the federal tied house statutes already prohibit agreements that result in exclusion of competitors’ product.
- Public stadiums are expensive to build and operate and they provide a public benefit. Selling the rights to name a stadium or other facility, or a club within a facility, can generate a significant amount of revenue. These tied house restrictions deny the public a source of revenue that is available in other states, and those dollars are going to the states where it is allowed.
- According to the sports and entertainment facility representatives, there is clear evidence that advertising and sponsorship relationships have not led to reduced competition. Advertisers want presence in our facilities primarily for branding, affiliation with sports and to be in front of target audiences. They do not enter into these agreements to sell more product at the venue.

#### **REGULATOR’S PERSPECTIVE:**

- If a firm is receiving profit from the sale of alcohol, that is a financial interest. And the current state Tied House prohibition against a certain types of advertising by retail licensees are in place to avoid creating a situation where the licensee is induced to favor one manufacturer over another.
- In the situation described above, the food and beverage operator would likely be dependent to some extent on the revenue generated by their contract at that Stadium, and they would know that Geoduck is providing financial benefit to Common Owner. That knowledge creates subtle pressure to sell Geoduck over other products because they don’t want to put their own contract with the stadium operator in jeopardy.
- Sports and entertainment facilities are not the only ones who want to enter into these kinds of arrangements. Recent examples are available where a manufacturer wanted to join with a restaurant to create the same type of “club” approach.

#### **PUBLIC HEALTH AND SAFETY PERSPECTIVE:**

- Naming of public facilities or clubs within those facilities by an alcohol beverage manufacturer is another form of advertising that encourages consumption. In the context of a sports facility, this could have a specific influence on youth.
- “Several forms of alcohol advertising predict adolescent drinking: which sources dominate depends on the child’s prior experience with alcohol. Alcohol prevention policies and programs should help children counter alcohol advertising from multiple sources and limit exposure to these sources.” (*Does Alcohol Advertising Promote Adolescent Drinking? Results from a Longitudinal Assessment.* Ellickson, Collins, Hambarsoomians, and McCaffrey, September 2004)
- In a report by the FTC in 1999 entitled, *Self Regulation in the Alcohol Industry: A Review of Industry Efforts to Avoid Promoting Alcohol to Underage Consumers*, the FTC recognized the impact of advertising on underage consumers and called for the industry to raise significantly the standards for the placement of advertising because then-current standards permitted alcohol advertising to reach a large number of underage consumers. Naming of facilities is broad-based advertising.

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- The Beer Institute’s code prohibits placement of ads “where most of the audience is reasonably expected to be below the legal purchasing age.” Stadiums, especially baseball, promote activities as family-oriented, have special giveaways for youth like backpacks, shirts and baseball cards, and promote youth-themed days such as “Little League Weekend.”

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#### SCENARIO 2 – MONEY’S WORTH AND THE WINE INDUSTRY

*Money’s worth issues are a concern for a variety of retailers, including restaurants, grocers, beer and wine producers and distributors. This Scenario focuses on issues related to the wine industry as a way to focus discussion on specific examples. The examples included here are intended to be illustrative only, not an exhaustive summary of issues related to the prohibition against providing money or money’s worth to licensees.*

The in-state wine producers’ marketing strategy is “educate and inform, experience and purchase.” As this strategy implies, their emphasis is on finding ways to access the consumer to give him or her an opportunity to learn about the products, and taste them. And once the consumer has been exposed to the state’s wines, they will purchase them. In-state wine producers are concerned the Tied House laws limit their activities in a number of ways that constrain the industry’s ability to market their product to consumers, without serving a significant public purpose.

The Tied House laws are intended to prevent domination of one tier over another and prevent inducement of retailers to favor some manufacturers to the exclusion of competitors. The concern is that such domination or exclusion will create circumstances in the marketplace that ultimately lead to abusive consumption (overserving, underage drinking, etc.).

- Wine producers often find it difficult to draw a correlation between the activity that is prohibited by the Tied House law and abusive consumption.
- LCB enforcement staff sees each potential exception as an erosion of the state’s ability to hold the line against domination and inducement. Although some of the activities that are prohibited may seem innocuous, the underlying rationale for the prohibitions have broader application and allowing these seemingly minor exceptions would start the state down a slippery slope.

#### EXAMPLES:

**A winery’s website can list the retailers at which the wine is sold, but cannot provide a link to those retailers.**

- According to the LCB, such a link provides value to the retailer and therefore is a violation of the money’s worth provision.

**A local restaurant wants to host a “wine dinner” in which the chef prepares dinner for guests, and pairs each course with a local producer’s wine. The restaurant asks the wine maker to attend, talk about her wine, but the vintner cannot pour the wine. (Or, in the reverse, a winery wants to host a wine dinner featuring a prominent chef from a regional restaurant.)**

- The basic Tied House rule is that a manufacturer cannot provide a thing of value to a retailer because it could result in an inducement to sell that manufacturer’s product and exclude a competitor. A specific narrow exception to this general rule was carved out to allow wineries to educate consumers about the industry and their products. That specific exception did not extend to pouring (which could free up the retailer’s staff to do other productive activities, thus providing “value” to the retailer.) Without an exception, the general prohibition applies.

**A winery may hold a license to operate a restaurant on or contiguous with winery property, but may not operate a restaurant on their off-site retail premises. (So, for example, Chateau**

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Ste. Fred could not open a restaurant, separate from its winery, where only Ste. Fred wines are served.)

- This would be a violation of the Tied House law prohibition against manufacturers owning a retail license. Exceptions to this prohibition have been provided to in-state wineries and breweries to hold certain retail licenses on their own premises, and in-state wineries to operate up to two off-site tasting rooms/off-premise retail outlets. But these exceptions have not been extended to allow the operation of a restaurant that serves only their own product off site.

**Most local wine makers are members of an industry association. Their dues fund the association’s operations, and for tax purposes they are generally considered 501(c) (6) organizations [“business leagues” per IRS]. These associations often distribute marketing materials that include advertising by wineries and by retailers. Because the associations are funded by the winemakers, this is a violation of the Tied House prohibition against joint advertising with retailers.**

- If a winery advertises its product and joins with a liquor retailer to indicate where that product can be obtained, that is a value to the retailer. Wineries cannot include in their advertising the name of a retailer. Wineries cannot do as a group what an individual winery could not do.
- A retailer can advertise a brand of alcohol if the retailer initiates the advertising and doesn’t receive payment from the supplier for doing so. In the case of an independent magazine advertising suppliers and retailers, the magazine gets the money, not one of the liquor licensees.
- **It’s not what is advertised, it’s who benefits.** Suppliers want access to a retailers customers by advertising that their product is available at that location or inferring that it is. The 2006 legislature adopted an exception that allows wineries to collectively produce tourism promotions that help tourists who want to come to a region to taste product find places to eat and sleep. That is all these trade groups can do. The wine commission is designed to market product and has a broader exception to tied-house to do so. For whatever reason, these regional groups of wineries have not chosen to use this vehicle.

**A special occasion license is granted to nonprofit organizations to hold events at which liquor is served. Industry associations are prohibited from obtaining special occasion licenses. This precludes the associations from hosting wine tastings that would allow them to educate consumers and give them a chance to “experience” the product, and would raise funds for the operation of the associations.**

- **Industry Perspective:** The Special Occasion License statute (RCW 66.24.380) provides for a special occasion license to be available to “nonprofit” organizations. It does not specify “charitable” organizations. A 501(c) (6) (“business league”) entity is a non-profit organization and should be allowed to hold a special occasion license.
- **State Perspective:** Wineries can’t be retailers except in certain circumstances. They can sell their own product from the winery. They can promote and sell their product at two additional offsite locations. They cannot go anywhere and act as a retailer. A special

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occasion license is a retail license designed for non-profit organizations to raise money for their causes by using alcohol. Wineries who group together in an association are still wineries and using a special occasion license is holding both a manufacturing license and a retail license outside of the narrow exceptions allowed for wineries. Again, the Wine commission can do things in the name of promotion of the industry that individual wineries cannot by virtue of state law exception specifically for the Commission.

Creating an exception allowing manufacturers to jointly advertise their products with specific retailers can lead to manufacturers being the necessary financing keeping some retail outlet in business. The influence of the manufacturer to get a retailer to sell product at reduced prices to get customers in the door can result in over-service and selling to whoever will come in and buy like young people under the age of 21.

If wineries as manufacturers can jointly advertise their products with retailers to promote and sell their wine, why shouldn’t Coors be able to jointly advertise their product with Mike’s Tavern. Even if they shared the cost, how would the LCB know if the manufacturer was paying the entire cost to help Mike’s get customers in the door or providing some other benefit to cover the joint cost of the advertising?

**Appendix I (5) – Issue Papers**  
**Impact Measures for Assessing 2SSB 6823**

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Appendix I (5)  
\* \* \* Issue Paper Developed to Inform the Task Force \* \* \*  
Policy Assessments, Impact Assessments and Potential Options were drafted to spark  
discussion and were not necessarily adopted or confirmed by the Task Force  
Impact Measures for 2SSB 6823

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**ASSESSING IMPACTS OF 2<sup>nd</sup> Substitute Senate Bill 6823**  
**EXPANDING SELF-DISTRIBUTION AUTHORITY**  
**TO OUT-OF-STATE WINERIES AND BREWERIES**

**ISSUE STATEMENT:**

*The Three-Tier Task Force was directed by the legislature to identify key issues, concerns and desired changes by the stakeholders about the current system, and to identify alternatives or modifications to the system. The Task Force was also specifically directed to research and analyze the impacts and implications of Second Substitute Senate Bill 6823 (and other suggested modifications to the system) on distributors, producers, retailers and consumers.*

**BACKGROUND:**

In 2006, the Legislature passed Second Substitute Senate Bill 6823 (Chapter 302, Laws of 2006) authorizing out-of-state wineries and breweries to distribute beer and/or wine of their own production directly to Washington retailers. (Out-of-state manufacturers are referred to as certificate of approval holders or “COAs.”) To self-distribute, COAs must first obtain a direct shipment endorsement, for an annual fee (currently \$100).

This legislation was prompted by the District Court’s decision in *Costco Wholesale Corp. v. Hoen, et al* (2006). The House Bill Report on 2SSB 6823 states:

*In Costco ... Judge Marsha Pechman of the U.S. District Court for the Western District of Washington struck down the Washington laws that allow in-state, but not out-of-state, wineries and breweries to distribute their products directly to retailers. Relying on the Supreme Court’s decision in Granholm [v. Heald (2005)], the District Court concluded that these laws discriminate against out-of-state wineries and breweries in violation of the Commerce Clause. In crafting a remedy, the District Court declined to extend the distribution privilege to out-of-state wineries and breweries or withdraw the distribution privilege from Washington producers. Instead, the District Court stayed the entry of judgment until April 14, 2006, to provide the Legislature with sufficient time to act.*

**This bill represents an expansion of previously existing authority** for self-distribution.

Licensed in-state wineries and breweries have had this authority since the mid-1930s<sup>1</sup> (the authority was extended to in-state microbreweries in 1997 when the statutes were changed to acknowledge this specific type of brewery.) It is unclear how many state wineries and breweries use this authority or how much beer and wine is sold through this authority, however it is clear only a small portion of the wine and beer sold is sold through self-distribution.

Until this year, in-state breweries and wineries were not required to report the amount of product sold through self-distribution. Brewery and winery tax reporting did allow the WSLCB to track the direct sale of product, but does not distinguish between product sold from manufacturer to retailer versus product sold from manufacturer to consumers on their premises (for example, product sold

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<sup>1</sup> Title 47, Intoxicating Liquors, RRS § 7306-24 and RRS § 7306-24A(2), 1939.

## Appendix I (5)

### Impact Measures for 2SSB 6823

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to consumers in on-site retail shops.) The following data is provided for ALL direct sales, which will be somewhat higher than the amount sold through self-distribution authority.

- In Fiscal Year 2006 (FY-06), 93 of the 97 licensed in-state breweries (96%) used this authority (2% of all beer sold in Washington in FY-06 was sold to retailers and consumers through direct sales.)
- And, also in FY 2006, 315 of the 438 licensed in-state wineries (72%) licensed in Washington used this authority (8% of all wine sold in Washington in FY-06 was sold to retailers and consumers through direct sales.)

Appendix A provides comparative data on direct sales for the years FY01-FY06.

Self-distribution authority was not extended to authorized representatives or importers, so foreign wine and beer must still be sold to a licensed Washington distributor.<sup>2</sup> To date, 51 COAs have applied for the additional direct shipment endorsement.

**In addition to granting self-distribution authority to COAs with direct shipment endorsements, the bill contained several other provisions. (These provisions already apply to in-state manufacturers that self-distribute beer or wine.):**

- COAs that self-distribute are required to submit to the board monthly reports showing the quantity of beer or wine sold or delivered to retailers. Prior to this bill's passage, COAs were already required to submit monthly reports showing the quantity of product sold to distributors and importers.
- COAs that self-distribute are responsible for paying the barrel tax or liter tax on the product they sell to licensed retailers. (When product is sold through a distributor, the distributor is responsible for paying the barrel or liter taxes based on the amount of product the distributor purchases from the manufacturer.)
- COAs that self-distribute must post their prices as a distributor, and comply with uniform pricing requirements and the prohibition against quantity discounts.

The bill **allows a retailer to contract with a common carrier to pick up and deliver the product if the product is being purchased from a manufacturer.** Unless the retailer chooses to exercise this option, the manufacturer must either deliver the product to the retailer's place of business using its own vehicle or the retailer must pick up the product from the manufacturer. (Traditional distributors do not have the authority to use common carriers to deliver their product to retail customers.)<sup>3</sup>

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<sup>2</sup> In FY06, approximately 34% of the wine and beer sold in Washington is imported from out of country. This was up from 19% in FY05.

<sup>3</sup> The bill also appears to allow self-distributors to allow for a freight differential in their product prices to retailers. Testimony offered about this issue during legislative hearings suggested this is a technical error, as it could result in violations of the uniform pricing requirement. The LCB has issued an interpretive statement clarifying that, "[f]reight differentials are not allowed with prices posted by distributors or producers acting as distributors for their own product for sale to retailers as a distributor."

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### Impact Measures for 2SSB 6823

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Under the provisions of 2SSB 6823, **retailers that purchase product through self-distribution must provide the WSLCB with a monthly report on product purchased in the previous month.** Retail reporting has not been required when purchasing from in-state wineries or breweries. Some retailers raised concerns about the impact this new reporting requirement could have on their workload. According to the LCB, however, this additional reporting requirement is an important crosscheck. Since the LCB has never had to collect taxes from out-of-state firms, they are concerned that there is no tracking mechanism in place to ensure all COAs are accurately reporting their in-state retail sales and remitting the appropriate taxes. An on-line reporting system will be implemented to keep the impact on retailers as low as possible. The WSLCB is requiring retailers to obtain a no-cost additional endorsement to purchase directly from producers. Approximately 50 retailers have applied for this endorsement.

**According to the WSLCB Fiscal Note on 2SSB 6823, the following fiscal and workload impacts are anticipated:**

- Of the 714 COAs, the LCB assumes that 50% or 357 will apply for a direct shipment endorsement at a fee of \$100.
- 706 restaurants, 297 specialty shops, and 227 grocery stores (a total of 1,230 retailers – approximately 10% of the total number of licensed retailers in FY 2005) will take advantage of self-distribution of product to their establishments.
- In addition, the LCB anticipates adding 12 new FTEs to oversee the implementation of the new processes for collecting excise taxes from manufacturers; to issue licenses; and to conduct audit and enforcement activities. They estimated biennial cost of approximately \$1.6 million.

Most sections of the bill took effect on April 14, 2006. This allowed the Liquor Control Board an opportunity to work with industry and other state agencies to establish new processes to accommodate this authority. The price posting, common carrier, public disclosure provisions and the LCB reporting requirements took effect on July 1, 2006. While the new authority was implemented on the 1<sup>st</sup> of July, the LCB is working to bring the rules into compliance with the new law.

Response to the legislation is mixed. The following perspectives were expressed during recent stakeholder interviews:

- In-state wineries were particularly concerned that without this legislation, the existing authority for in-state producers to self-distribute would be eliminated. Since the economic viability of many in-state wineries depends on this method of distribution, the expanded authority was preferred to eliminating it altogether.
- Many manufacturers and retailers are concerned that the bill did not go far enough to eliminate barriers to self-distribution. The two most common complaints were that: 1) the bill does not allow central warehousing, which would facilitate less expensive and more efficient distribution of product at the retailer level, and 2) it does not allow manufacturers to contract with common carriers to deliver product. This is a reflection of a commonly expressed view by participating manufacturers and retailers that the three-tier system is less relevant in today's environment and should be relaxed or eliminated to allow a more free-market approach to the distribution and sale of beer and wine.

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### Impact Measures for 2SSB 6823

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- Many distributors are concerned that further expansion of the self-distribution authority will harm the traditional distributor industry and will ultimately result in loss of jobs throughout Washington. Some distributors (particularly independent wine distributors), however, agreed with manufacturers and retailers that a more flexible, free-market approach would be more appropriate in today's environment and felt they could be competitive even with the expanded self-distribution authority.
- Stakeholders from the prevention and treatment community and many distributors expressed a concern that the expanded authority represents a further erosion of the state's three-tier system. They fear that weakening the system will result in less ability to monitor and control the flow of alcohol into and throughout the state and ultimately will result in increased illegal sales and abuse of alcohol.

### Analyzing the Results of 2SSB 6823

Since the provisions of the bill just recently went into effect, the impacts of changes cannot yet be analyzed. However, the Task Force *can* identify *potential* impacts and implications and recommend indicators that should be measured to assess the actual impacts when there is more experience with the changes. The LCB will likely require additional resources for ongoing data collection, analysis and reporting related to impact measures. A list of some potential impacts and corresponding measures are presented below.

1. A winery or brewery certificate of approval holder [out-of-state winery or brewery] with a direct shipment endorsement may now **sell their own product to retailers** (before they could sell to wine/beer distributors or importers only). [6823 sec. 4 (1)(a) and sec. 6 (2)(a) amends RCW 66.24.206 and RCW 66.24.270]

Potential Impacts	Potential Measures
Increased selection resulting from increased access by out-of-state manufacturers	# of COAs with direct shipment endorsements # of Retailers with endorsements for direct purchase
Decreased employment in traditional distributors	# of employees in beer and wine wholesale industry, as reported by ESD
Loss of tax revenues due to underreporting	Liter and barrel taxes paid by distributors; liter and barrel taxes paid by in-state and out-of-state self-distributors; COA monthly sales reports data

2. **Certificate of approval holders** are required to file a **monthly sales report** to include sales to **retailers** (previously just had to report sales to distributors) to the LCB. [6823 sec. 4(2). Amends RCW 66.24.206]

Potential Impacts	Potential Measures
Increased LCB administrative costs	# of FTEs # of transactions from self-distribution related to tax collection and enforcement

## Appendix I (5)

### Impact Measures for 2SSB 6823

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3. **Certificate of approval holders with a direct shipment endorsement consent to the jurisdiction of Washington concerning enforcement of this chapter and all laws and rules related to the sale and shipment of wine.** [6823 sec. 4(4). Amends RCW 66.24.206] **and beer** [6823 sec. 6 (5)]

Potential Impacts	Potential Measures
Reduced ability to enforce as a result of fewer enforcement options when dealing with out-of-state entities	# and type of violations issued to in-state v. out-of-state entities

4. **Any certificate of approval holder acting as a distributor of its own product shall pay liter or barrel taxes.** [sold to wine distributors and the LCB] [6823 sec.5 (1) and sec. 7 (1). Amends 66.24.210 and 66.24.290]

Potential Impacts	Potential Measures
Loss of tax revenue due to underreporting	Anticipated revenues based on previous tax collections compared to actual liter and barrel taxes paid by distributors and liter and barrel taxes paid by self-distributors
Increased effort to enforce	Cost of additional enforcement staff; # of violations

5. **Licensed retailers authorized to purchase wine or beer from a certificate of approval holder with a direct shipment endorsement or domestic winery, brewery or microbrewery shall make monthly reports to the LCB on wine/beer purchased...**[wine 6823 sec.5 (1). Amends 66.24.210 and **beer** 6823 sec.7 (1)(d) Amends RCW 66.24.290]

Potential Impacts	Potential Measures
Increased work load for retailers	# of retailers reporting, and time to submit report (time associated with data collection and preparation of report.)
Improved ability to identify underreporting	# of inconsistencies between self-distributor report and retailer report

## Appendix I (5) Impact Measures for 2SSB 6823

6. **Licensed retailers may contract with a common carrier to obtain product directly from a domestic or certificate of approval holder** with a direct shipment endorsement (winery or brewery) acting as a distributor of its own product. [6823 Sec. 9 (2)(ii) Amends RCW 66.28.180]

Potential Impacts	Potential Measures
Increased potential for diversion of product and illegal sales	# of complaints received via hotline

### General Impacts

Potential Impacts	Potential Measures
Consumers	
<ul style="list-style-type: none"> <li>Increased consumer selection of beer and wine products</li> <li>Lower retail prices</li> </ul>	<ul style="list-style-type: none"> <li># of COA licensees and # of labels available in Washington</li> <li>Survey of beer and wine prices</li> </ul>
State government	
<ul style="list-style-type: none"> <li>Decreased control over the flow of alcohol into Washington</li> <li>Decreased tax revenues resulting from untraceable underreporting</li> </ul>	<ul style="list-style-type: none"> <li># of illegal sales violations</li> <li>Anticipated tax revenues (based on previous history) compared to actual revenues</li> </ul>
Society	
<ul style="list-style-type: none"> <li>Increased illegal sales of beer and wine</li> <li>Increased youth consumption</li> <li>Increased abusive consumption</li> </ul>	<ul style="list-style-type: none"> <li># of illegal sales violations</li> <li># of underage sales violations</li> <li># of DUIs, # of traffic fatalities involving alcohol</li> </ul>

### POLICY OPTIONS for CONSIDERATION:

The LCB should identify and select key impact measures that can be monitored and analyzed by the Fall of 2007, in order to provide the Legislature with data about the impacts related to implementation of 2SSB 6823 (expanding self-distribution authority to out-of-state breweries and wineries).

- The LCB is encouraged to work with stakeholders and legislative staff to identify the most pertinent impact measures.
- Key impact measures should be tied to the state's policy goals and should address the impact to industry, consumers, the state, and society in general.
- To the extent possible, consideration should be given to selecting measures for which baseline data is already available.

## Appendix I (5) Impact Measures for 2SSB 6823

### APPENDIX A:

A relatively small portion of wine and beer sold in Washington is sold by in-state producers through direct sales (including both self-distribution to retailers and on-site direct sales to consumers).

- Approximately 8% of all wine sold in Washington in FY-06 was sold through direct sales (17% of all Washington-produced wine was sold through direct sales).
- Approximately 2% of all beer sold in Washington in FY-06 was sold through direct sales (36% of all Washington-produced beer was sold through direct sales.)

Wine Sales in gallons:						
	FY-01	FY-02	FY-03	FY-04	FY-05	FY-06
WA DOMESTIC WINERIES						
Self distributing/retail	971,192	1,424,607	2,629,599	2,688,984	1,303,506	1,720,690.00
WA Distributor	5,149,215	6,078,412	5,972,945	6,702,711	7,683,496	8,351,441
<b>Totals:</b>	<b>6,120,407</b>	<b>7,503,019</b>	<b>8,602,544</b>	<b>9,391,695</b>	<b>8,987,002</b>	<b>10,072,131</b>
Percentage of Wine Direct Sales Compared to all WA Domestic Wineries Sales						
	16%	19%	31%	29%	15%	17%
Total Sales in Washington	15,471,979	15,653,088	17,737,279	18,856,619	19,195,000	20,341,678
Percentage of Wine Direct Sales Compared to all Sales in WA	6%	9%	15%	14%	7%	8%

Beer Sales in Barrels:						
	FY-01	FY-02	FY-03	FY-04	FY-05	FY-06
WA DOMESTIC BREWERIES						
Self distributing/retail	47,012	80,656	77,660	73,093	76,460	79,315
WA Distributor	712,198	1,152,875	993,906	216,977	155,699	142,878
<b>Totals:</b>	<b>759,210</b>	<b>1,233,531</b>	<b>1,071,566</b>	<b>290,070</b>	<b>232,159</b>	<b>222,193</b>
Percentage of Beer Direct Sales Compared to all WA Domestic Breweries Sales						
	6%	7%	7%	25%	33%	36%
Total Sales in Washington	4,266,404	4,138,871	3,971,650	4,042,972	4,032,234	3,882,079
Percentage of Beer Direct Sales Compared to all Sales in WA	1%	2%	2%	2%	2%	2%

Source: LCB Tax Report Data

## **Appendix I (6) – Issue Papers**

### **General LCB Policy Impact Measures**

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## Appendix I (4)

**\* \* \* Issue Paper Developed to Inform the Task Force \* \* \***

**Policy Assessments, Impact Assessments and Potential Options were drafted to spark discussion and were not necessarily adopted or confirmed by the Task Force**

### **General LCB Policy Impact Measures**

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#### **CONTROL AND ENFORCEMENT CATEGORY:**

##### **General LCB Policy Impact Measures**

#### **ISSUE STATEMENT:**

*The LCB currently lacks sufficient research and analysis capabilities to demonstrate a connection between the state's beer and wine distribution and sales regulatory structure and achieving its policy goals of reducing abusive consumption, efficient tax collection and orderly distribution of beer and wine. In addition, the state lacks baseline data and on-going data collection and analysis capability to demonstrate the effects of changes in policies related to the distribution and sale of beer and wine.*

#### **DISCUSSION:**

**Currently, the state does not have an on-going research program in place to assess the effectiveness of the current regulatory system to control the distribution and sale of beer and wine in supporting or achieving the state's policy goals.** The lack of Washington-specific data and analysis capability was evident in the recent Costco ruling. Throughout the court's findings of fact and conclusions of law, the judge made reference to the fact the state had insufficient evidence to support its claims that state regulations support the policy goals they were designed to achieve. The court found that "the effectiveness of [the state's regulatory] restraints in advancing the state's interests under the Twenty First Amendment has largely gone unstudied, and there is little evidence that the restraints are effective in advancing the state's interests in promoting temperance, ensuring orderly market conditions, or raising revenue."

**Washington is not alone in its lack of ability to measure the impact of its beer and wine distribution policies.** Only three of the states responding to the alcohol policy survey stated they currently have impact measures in place. Montana monitors the use of a quota system for licensing, tax collections and enforcement activities; Utah measures rates of consumption; and Wyoming uses the results of enforcement stings to help determine best practices for their Liquor Division. As the regulatory structure changes in response to stakeholder demands and court rulings, policy makers will become increasingly concerned with the impacts of these changes on society, industry, consumers and the state. Given that state resources (both financial and human) are limited, monitoring and evaluation also play an important role in identifying areas that should be given a high priority.

Further, alcohol policy issues are complex, vary widely across the nation, and can be impacted upon by a diverse range of socioeconomic factors that are beyond the influence of the state's distribution regulatory scheme. This complexity, however, does not prohibit the use of impact measures. To ensure the state's policies are being successfully implemented, it is essential that processes are in place to continuously monitor performance. The resulting data then can be used to regularly assess and, if necessary, reformulate the state's strategic directions. Assessing the state's approach to alcohol distribution and sale against predefined objectives can assist the Governor, the Legislature,

## Appendix I (6)

### General LCB Policy Impact Measures

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the Liquor Control Board, other state agencies and local government to identify both successful and unsuccessful policy approaches.

**Designing appropriate impact measures is a critical step in getting a measurement system that works.** Policy goals have to be expressed as impact measures and targets. It is easy to measure what is simple to measure rather than what really matters. Developing appropriate, relevant, sound impact measures is a difficult task, and identification of the specific indicators, data sources, and outcomes is beyond the scope of this issue paper. In general, useful impact measures are outcome-focused, measurable, and include achievable targets.

- **The LCB currently collects a wealth of data related to the distribution of alcohol, but legacy information systems makes it cumbersome to translate the data into useful information.** The LCB has been working to upgrade their technology both to make it more user-friendly for their customers and to make it easier to extract data so it can be used in a meaningful way.
- **A significant amount of data related to alcohol-related outcomes (e.g., health costs, accidents, DUIs, youth consumption, etc.) is currently collected** by other state, federal and non-profit organizations. Identifying reliable resources, and when appropriate, bringing them to bear on these issues is both an efficient use of resources, and establishes a common set of data that stakeholders can all rely on. Linking these important sources of data and policy discussions about LCB's regulatory system is currently a difficult task.
- **No formal research structure currently exists to create these linkages between these outcomes and specific policy tools.** (This may be a result – in part at least – of a lack of basic research as well. In his testimony during the Costco case, a leading researcher in this area, noted, “empirical evidence on the impact of changes in these policies on alcoholic beverage prices, drinking, and its consequences is almost nonexistent. Clearly, more research is needed to fully understand the impact of the complex and varied policies that affect alcoholic beverage distribution, marketing, and pricing on the retail prices on of these beverages.”) **Impact measures should be designed in collaboration with the alcohol industry, the prevention and treatment community, and policy researchers so the resulting measures provide a common set of supported outcomes.**

### POLICY OPTIONS for CONSIDERATION:

*NOTE: These options are offered to stimulate discussion. **They are not necessarily the best or only alternatives available.** The analysis of potential benefits and drawbacks represents our best efforts at assessing impacts based on feedback received from industry members, and a brief review of relevant literature. They have not been thoroughly tested or evaluated.*

#### **OPTION 1: No action.**

Potential Benefits: No additional resources required.

Potential Drawbacks: No ability to measure the effectiveness of current regulations. No ability to measure the impacts of policy changes.

## Appendix I (6)

### General LCB Policy Impact Measures

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**OPTION 2: Recommend an initiative and funding for the LCB to develop and implement a research agenda to support policy development based on identified impact measures, including the development of baseline data against which to measure key changes in policy.**

Potential Benefits: Encourages the use of sound, reliable data in the development and on-going evaluation of alcohol distribution policy

Potential Drawbacks: Additional staff and financial resources will be needed to support this effort. Without adequate resources, the LCB will not be able to sustain the effort.